SUBJECT INDEX

PAGE

I.

Statement of grounds on which the jurisdiction of the court is invoked 2

II.

The questions presented for review 3

III.

Constitutional provisions and statutes which the case involves 5

IV.

Concise statement of the case containing facts material to consideration of questions presented 6

V.

Concise argument amplifying the reasons relied on for the allowance of the writ 11

1. Denial of due process of law 11

Discovery proceedings were denied to the petitioners 13

Prejudicial errors of the trial judge in admitting exhibits offered by the SEC 16

2. Did the Securities and Exchange Commission have authority to maintain this action and did the Federal Court have jurisdiction? 18

3. Does the decision of the Court of Appeals in this case conflict with the applicable decisions of this court as announced in the case of Gordon v. Washington, 259 U. S. 30, and Killeam v. Maryland, 312 U. S. 377, with respect to the circumstances where it is declared improper to appoint a receiver? 23

PAGE

4. Where the authority of the SEC to bring actions in the District Court is specified in Section 20(b) and (c) of the Securities Act of 1933 (15 U. S. C. 77t(b) and (c)), may the SEC disregard the limitations so imposed and bring an action under the broader provision of Section 22(a) of the Securities Act of 1933 (15 U. S. C. 77v(a)), which this court held in Deckert v. Independent Shares, 311 U. S. 282, was intended as a remedy for investors? 25

5. There is no provision in the federal law to require a District Court judge to file counter-affidavits to an affidavit charging him with bias and prejudice under 28 U. S. C. 144, nor that the question of bias and prejudice should be heard and determined by the presiding judge of his court. The only authorized procedure to test the sufficiency of such bias and prejudice is by appeal from a final judgment or some other appealable order 28

6. A judgment should be reversed if it was rendered by a trial judge who is shown to have been biased and prejudiced before the trial by affidavit filed under 28 U. S. C. 144, or who during the trial exhibited such hostility as to demonstrate bias and prejudice, irrespective of the apparent weight of the evidence in the case 29

APPENDICES

PAGE

Appendix I. Court of Appeals Opinion and Order of February 17, 1959, 264 F. 2d 199 1

Appendix II. Court of Appeals Order of October 16, 1959.. 29

Appendix III. District Court Final Judgment of Permanent Injunction and Order Appointing Receiver, Dated, May 20, 1960 31

Appendix IV. Court of Appeals Order of June 7, 1960..... 48

Appendix V. Court of Appeals Opinion and Order of July 14, 1960 51

Appendix VI. Court of Appeals Opinion of November 23, 1960 54

Appendix VII. Court of Appeals Order of January 10, 1961 95

Appendix VIII. Section 20(b) and Section 20(c) of the Securities Act of 1933..... 99

Appendix IX. Section 22(a) of the Securities Act of 1933....100

Appendix X. SEC Motion Filed September 2, 1959.....101

Appendix XI. Plaintiff's Exhibits and Objections Noted in Reporter's Transcript 103

TABLE OF AUTHORITIES CITED

Cases	Page
Albert v. U. S. District Court, 283 F. 2d 61	10, 28
American Manganese Steel Co. v. Alaska Mines Corporation, 250 Fed. 614	27
Bell Tel. Co. v. Commission, 301 U. S. 292	12
Berger v. United States, 255 U. S. 22, 41 S. Ct. 230	10, 28
Burns v. Lovett, 202 F. 2d 335	12
Burton v. Platter, 53 Fed. 901	12
Dartmouth College case, 17 (U. S.) 4 Wheat. 518	11
Davidson v. New Orleans, 96 U. S. 97, 24 L. Ed. 616	12
Deckert v. Independent Shares, 311 U. S. 282	4, 9
Galvan v. Press, 347 U. S. 522	11
Gordon v. Washington, 259 U. S. 30	23
Hovey v. Elliot, 167 U. S. 409	11
Killeam v. Maryland, 312 U. S. 377	23
Knapp v. Kinsey, 232 F. 2d 458	10, 28, 30, 33
Korer v. Hoffman, 212 F. 2d 211	10, 28
National Labor Relations Board v. Ford Motor Company, 114 F. 2d 905, cert. den. 312 U. S. 689	33
Rudder v. United States, 226 F. 2d 51	12
SEC v. Joiner, 320 U. S. 344	18
SEC v. W. J. Howey Co., 328 U. S. 293	18, 19, 22
Whitaker v. McLean, 118 F. 2d 596	28, 29, 33

Rules	
Federal Rules of Civil Procedure, Rule 27	13
Federal Rules of Civil Procedure, Rule 34	13
Rules of the United States Supreme Court, Rule 19(1)(b)	2

STATUTES	PAGE
Securities Act of 1933, Sec. 2(1)	18
Securities Act of 1933, Sec. 12	4, 9
Securities Act of 1933, Sec. 20(b)	4, 5, 9, 26
Securities Act of 1933, Sec. 20(c)	4, 5, 9
Securities Act of 1933, Sec. 22(a)	4, 5, 9, 26
United States Code, Title 15, Sec. 77b(1)	18
United States Code, Title 15, Sec. 77t(b)	4, 5, 9, 25, 26
United States Code, Title 15, Sec. 77t(c)	4, 5, 9
United States Code, Title 15, Sec. 77v(a)	4, 5, 9, 25, 26
United States Code, Title 15, Sec. 77(L)	4, 9
United States Code, Title 28, Sec. 144	5, 10, 31
United States Code Annotated, Title 28, Sec. 1254(1)	3
United States Constitution, Fifth Amendment	2, 3, 5, 6

IN THE

Supreme Court of the United States

OCTOBER TERM, 1960

No. .....

LOS ANGELES TRUST DEED & MORTGAGE EXCHANGE, TRUST DEED & MORTGAGE EXCHANGE, TRUST DEED & MORTGAGE MARKETS, DAVID FARRELL, OLIVER J. FARRELL, ROY A. BONNER, THOMAS WOLFE, JR., and STANLEY C. MARKS,

Petitioners,

vs.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

PETITION FOR WRIT OF CERTIORARI.

To Review a Decision of the U. S. Court of Appeals for the Ninth Circuit Affirming a Judgment of the U. S. District Court for the Southern District of California.

The petitioners above named respectfully petition and pray the Supreme Court to grant a writ of certiorari to review the judgment of the U. S. Court of Appeals for the Ninth Circuit, dated November 23, 1960, 285 F. 2d 162, as modified by its order on petition for rehearing dated January 10, 1961, ... F. 2d ....., affirming and modifying a judgment of the U. S. District Court for the Southern District of California, dated May 20, 1960. Copies of these judgments are appended hereto in chronological order, together with other interim orders.

I.
Statement of Grounds on Which the Jurisdiction of the Court Is Invoked.

The jurisdiction of the Court is invoked upon the following grounds, authorized by Rule 19, 1, (b) of the rules of this Court.

1. (a) That the court of appeals has rendered a decision in this case which has so far departed from the accepted and usual course of judicial proceedings, and has so far sanctioned such departure by the district court wherein the petitioners have been deprived of their property without due process of law; contrary to the guarantee provided by the Fifth Amendment to the U. S. Constitution, all of which calls for the exercise of this court's power of supervision; and

(b) That the court of appeals has rendered a decision in this case on federal questions in conflict with applicable decisions of this court; and

(c) That the court of appeals has rendered a decision in this case on important questions of federal law which have not been, but should be, settled by this court.

2. The judgment of the court of appeals sought to be reviewed was dated November 23, 1960, and was entered on the same day.

3. On January 10, 1961 the court of appeals by written opinion denied a petition for a rehearing which had been presented by petitioners herein. No order granting an extension of time within which to petition for certiorari has been requested or issued.

4. Jurisdiction in the Supreme Court to review the judgment in question by writ of certiorari is conferred by 28 U. S. C. A. 1254(1).

II.

The Questions Presented for Review.

The questions presented for review arise out of a civil action instituted and prosecuted under the Securities Act of 1933, and the Securities Exchange Act of 1934, by the Securities and Exchange Commission, as plaintiff, and against these petitioners as defendants, wherein the SEC sought, and obtained, various final injunctions, and the appointment of a receiver, who pursuant to his appointment took over the business and the assets of the petitioners Los Angeles Trust Deed & Mortgage Exchange, and Trust Deed & Mortgage Markets.

Special and important reasons for review are presented by the following circumstances:

The receiver also took and retained possession of trust deeds having a face value of approximately $39,000,000.00 belonging to some 9,000 customers of these corporations. The Securities and Exchange Commission stipulated that this was a "test case" [Tr. 6/22/59, p. 10] of federal jurisdiciton. The Court of Appeals conceded that in certain aspects this was "a case of near first impression . . ., and the Supreme Court has not as yet had an opportunity to rule on the precise question here involved." (Appen. *infra*, p. 91.)

First Question: Were the petitioners deprived of their property without due process of law, in violation of the guaranty afforded by the Fifth Amendment to

the U. S. Constitution, by reason of their having been wrongfully refused and denied in the district court those rights and remedies which by statutes and the Federal Rules of Civil Procedure have been established to protect the citizen against arbitrary action and to secure to all persons equal and impartial justice under the law?

Second Question: Did the Securities and Exchange Commission have authority to maintain this action, or the federal court jurisdiction of it, where the evidence failed to show the petitioners were dealing in securities as that term has been interpreted and defined by this court?

Third Question: Is the appointment of a receiver authorized in a federal court where the court is asked to make no further disposition of the property and where the appointment is not ancillary to some final relief which is appropriate for equity to give?

Fourth Question: Where Sections 20(b) and (c) of the Securities Act of 1933 (15 U. S. C. 77t(b) and (c)) constitute the only statutory authorities for the Securities and Exchange Commission to institute specified civil actions in the federal courts, can this action be maintained under Section 22(a) of the Securities Act of 1933 (15 U. S. C. 77v(a)) for the appointment of a receiver, in view of the decision of this Court in *Deckert v. Independent Shares,* 311 U. S. 282 (1940), holding that Section 22(a) (15 U. S. C. 77v(a)) was intended by Congress to provide a remedy for investors pursuing the civil liabilities provided by Section 12 of said Act (15 U. S. C. 77(L))?

Fifth Question: Do the rules of court, the case law, or the canons of judicial ethics, require a federal dis-

trict court judge to file counter affidavits to affidavits charging him with bias and prejudice under the provisions of 28 U. S. C. 144, and should the question of his bias and prejudice be then determined by the presiding judge of his court?

Sixth Question: If it should be shown that a district court judge was biased and prejudiced within the meaning of 28 U. S. C. 144, will his judgment in the case be affirmed if it appears the judgment is supported by the evidence and the complaining parties cannot show that otherwise they have not had a fair trial?

III.

Constitutional Provisions and Statutes Which the Case Involves.

1. *U. S. Constitution.*

The Fifth Amendment to the U. S. Constitution provides in part as follows:

> "No person shall . . . be deprived of . . . property without due process of law . . ."

2. *Securities Act of 1933.*

Sections 20(b) and (c) of the Securities Act of 1933 (15 U. S. C. 77t(b) and (c)) are printed in full in the Appendix *infra*, page 99.

Section 22(a) of the Securities Act of 1933 (15 U. S. C. 77v(a)) is printed in full in the Appendix *infra*, page 100.

3. *Bias or Prejudice of Judge.*

28 U. S. C. 144 reads as follows:

> "*Sec. 144.* Whenever a party to any proceeding in a district court makes and files a timely

and sufficient affidavit that the judge before whom the matter is pending has a personal bias or prejudice either against him or in favor of any adverse party, such judge shall proceed no further therein, but another judge shall be assigned to hear such proceeding. The affidavit shall state the facts and the reasons for the belief that bias or prejudice exists and shall be filed not less than ten days before the beginning of the term at which the proceeding is to be heard, or good cause shall be shown for failure to file it within such time. A party may file only one such affidavit in any case. It shall be accompanied by a certificate of counsel of record stating that it is made in good faith."

IV.

Concise Statement of the Case Containing Facts Material to Consideration of Questions Presented.

First Question: Were the petitioners deprived of their property without due process of law, in violation of the guaranty afforded by the Fifth Amendment to the U. S. Constitution by reason of their having been wrongfully refused and denied in the district court those rights and remedies which by statutes and the Federal Rules of Civil Procedure have been established for the protection of private rights and to protect the citizen against arbitrary action and to secure to all persons equal and impartial justice under the law?

Stated in another way, were the petitioners denied what is deemed to be the essence of due process, a fair and impartial trial, by a biased and prejudiced district court judge [R. p. 66];

Who so far departed from the accepted and usual course of judicial proceedings that he wrongfully and arbitrarily denied to the petitioners all discovery rights sought by them before the trial [R. pp. 78; 119; 89; 110]; and

Who, under the guise of discovery rights sought by the SEC, arbitrarily imposed unwarranted, unreasonable and oppressive sanctions against these petitioners [R. p. 167]; and

Who, without justification, during four important days of the trial, wrongfully prohibited Mr. Cuthbertson, counsel for Los Angeles Trust Deed & Mortgage Exchange, and Mr. Foley, counsel for its president, David Farrell, from effectively participating in said trial on behalf of those petitioners, although permitting them to participate on behalf of other petitioners;[1] and

Who, in utterly ignoring the established rules of evidence, such as identification, verification and foundation, permitted the SEC, over proper objections, to place in evidence a hundred or more immaterial and irrelevant documents, prejudicial to the petitioners and calculated to nourish and inflame the bias and prejudice of said judge;[2] and

Who issued written orders, prejudicial to the petitioners and favoring the SEC, ostensibly in response to motions made therefor, when in fact there were no such motions made, or no notice of motion given, or

---

[1]See copy of SEC motion filed September 2, 1959, Appendix, *infra*, p. 101, and Order of October 5, 1959, granting that motion. [R. p. 210.]

[2]See schedule printed in Appendix, *infra*, p. 103.

no opportunity for hearing thereon, or no evidence received by way of affidavit or otherwise to support said orders; and

Who, throughout the trial, sought to intimidate counsel for petitioners from doing what was necessary to protect the record, by unwarranted threats of punishment, and on one occasion by an actual physical assault upon one of counsel for petitioners, coupled with the threat that he, the said judge, intended then and there to personally impose great bodily harm upon said counsel.[3]

Second Question: Did the Securities and Exchange Commission have authority to maintain this action, or the federal court jurisdiction of it, where the evidence failed to show the petitioners were dealing in securities as that term has been interpreted and defined by this Court, and where the evidence did show that the petitioners bought for their own account and sold to others in transactions as principals and not as agents, trust deeds on California realty, and where the purchaser could not look solely to the petitioners or any other person to do what might be necessary to protect his purchase but was required to actively participate himself in the management of trust deeds so acquired?

Third Question: Is the appointment of a receiver authorized in a federal court where the court is asked

---

[3]An affidavit establishing the facts of this assault was ordered to be sealed by the court of appeals at the end of its opinion and order dated July 14, 1960 (Appen., *infra*, p. 53), and a later request by petitioners that this order be revoked was denied in the order of January 10, 1961, denying a petition for rehearing, as follows: "The request that this court revoke its order of July 14, 1960, sealing a certain document, is presently denied." (Appen., *infra*, p. 98).

to make no further disposition of the property and where the appointment is not ancillary to some final relief which is appropriate for equity to give and where the purpose for the appointment is ". . . to maintain in *status quo* the assets of the appellants and the respective purchasers of the second trust deeds until such time as the appellants can comply with the law, or dissatisfied trust deed holders or other creditors may take the necessary steps to prove by regular and ordinary methods that the several appellants are insolvent and/or unable to meet their obligations?" (Decision of November 23, 1960, p. 91, Appen. *infra.*)

Fourth Question: Where Sections 20(b) and (c) of the Securities Act of 1933 (15 U. S. C. 77t(b) and (c)) constitute the only statutory authorities for the Securities and Exchange Commission to institute specified civil actions in the federal courts, can this action be maintained under Section 22(a) of the Securities Act of 1933 (15 U. S. C. 77v(a)) for the appointment of a receiver, in view of the decision of this court in *Deckert v. Independent Shares*, 311 U. S. 282 (1940), holding that Section 22(a) (15 U. S. C. 77v(a)) was intended by Congress to provide a remedy for investors pursuing the civil liabilities provided by Section 12 of said Act (15 U. S. C. 77l(a)), and where it appears that the Securities and Exchange Commission in the exercise of its quasi-judicial powers with respect to the Securities Act of 1933 had determined that it was not entitled to employ the broader powers of Section 22(a) and seeking such powers, in 1957 urged Congress to adopt a bill to amend the law, which bill was never reported out of committee and was never enacted?

Fifth Question: Do the rules of court, the case law, or the canons of judicial ethics, require a federal district court judge to file counter affidavits to affidavits charging him with bias and prejudice under the provisions of 28 U. S. C. 144; and is the question of his bias and prejudice then to be determined by the presiding judge of this court, as declared in the decision of the court of appeals in this case, dated November 23, 1960 (p. 73, Appen. *infra*), or by a motion to disqualify, as suggested in the same decision (p. 74, Appen. *infra*), where the court observed that ". . . no new motion to disqualify the trial judge was made below", or is the question of the disqualification of such a judge as to whom such an affidavit is filed only reached by the court of appeals on an appeal on some other and appealable order, as declared by this Court in *Berger v. United States*, 255 U. S. 22, 41 S. Ct. 230, by the Court of Appeals for the Sixth Circuit in *Knapp v. Kinsey* (1956), 232 F. 2d 458, and in *Albert v. U. S. District Court* (1960), 283 F. 2d 61, and the Court of Appeals for the Seventh Circuit in *Korer v. Hoffman*, 212 F. 2d 211?

Sixth Question: If it should be shown that a district court judge was biased and prejudiced within the meaning of 28 U. S. C. 144, will his judgment in the case be affirmed if it appears the judgment is supported by the evidence, and the complaining party cannot show that otherwise he has not had a fair trial, as declared by the Court of Appeals in this case in its decision of November 23, 1960 (p. 74, Appen. *infra*), where it concluded:

"While admittedly the statements charged by the trial judge, if true, even though not made in open

court but at an informal conference in chambers, would have been better left unsaid, yet we cannot say such statements as a matter of law prevented a fair trial to the appellants in view of the plethora of evidence presented to us by the record herein which fully generally supports the court's findings and judgment."

or is any judgment rendered by a biased and prejudiced judge which deprives a person of his property presumptively a denial of due process of law, irrespective of the apparent weight of the evidence in the case?

V.

Concise Argument Amplifying the Reasons Relied on for the Allowance of the Writ.

1. Denial of Due Process of Law.

Petitioners rely, in support of their contention that they have been deprived of their property without due process of law, upon the rule established in 1819 in the *Dartmouth College Case*, 17 (U. S.) 4 Wheat. 518, restated by this Court in 1897 in the case of *Hovey v. Elliot*, 167 U. S. 409, and consistently followed by this Court in such cases as *Galvan v. Press* (1954), 347 U. S. 522, 530, wherein this Court declared that "fair play" is the "essence of due process".

In the earlier case of *Hovey v. Elliot*, a defendant was prevented from presenting his defense in a civil action. This was held to be a denial of due process. Due process was defined by the court as (p. 419)

". . . a law which hears before it condemns, which proceeds upon inquiry and renders judgments only after trial. The meaning is that every citi-

zen shall hold his life, liberty, property and immunities under the protection of the general rules which govern society."

This Court, in the case of *Davidson v. New Orleans* (1877), 96 U. S. 97, 24 L. Ed. 616, 620, had earlier said with respect to a judicial proceeding, that due process required ". . . a fair trial in a court of justice according to the modes of proceeding applicable to such case." Again in *Ohio Bell Tel. Co. v. Commission* (1937), 301 U. S. 292, 300, this Court held that a "fair hearing" was "essential to due process."

The Court of Appeals for the Eight Circuit, in *Burton v. Platter* (1893), 53 Fed. 901 at page 904, defined due process as:

> "Certain it is that, in judicial proceedings, due process of law must be a course of legal proceedings, according to those rules and forms which have been established for the protection of private rights. It must be one that is appropriate to the case, and just to the parties affected. It must be pursued in the ordinary manner prescribed by the law. It must give to the parties to be affected an opportunity to be heard respecting the justice of the judgment sought."

The Court of Appeals for the District of Columbia, in *Burns v. Lovett* (1952), 202 F. 2d 335, 341 stated the rule:

> "Essentials of a fair proceeding are requisites of due process of law under all conditions."

The same Court in 1955, in the case of *Rudder v. United States*, 226 F. 2d 51, 53, stated:

> "Arbitrary action is not due process of law."

It is respectfully contended that the record in this case establishes that the SEC, the Government agency which came into the district court as a civil litigant in this case, was singularly and unfairly favored at all stages of this trial, and that the defendants, petitioners herein, were denied a "fair trial" or a "fair hearing" and were subjected repeatedly to "arbitrary action" and by reason thereof have been denied due process of law.

Discovery Proceedings Were Denied to the Petitioners.

On June 4, 1959, the petitioners gave notice, under Rule 27 F. R. C. P., of the intention to take the depositions of Charles R. Burr and R. W. Rheinschild on June 11. [R. p. 117.]

On June 9, 1959, the SEC served on the petitioners a "Motion of Securities & Exchange Commission for Order that Depositions of Charles R. Burr . . . and R. W. Rheinschild . . . Shall Not Be Taken . . ., etc." [R. p. 126.]

No notice of motion was served with respect to the SEC motion, and no affidavits or evidence of any sort was either served on the petitioners or presented to the court.

The court announced that it would hear the motion on the following day, June 10, 1959. On June 10th the matter was argued, and in the absence of any evidence, either on behalf of the SEC or the petitioners, the motion was granted prohibiting the taking of the depositions. [R. p. 119.]

Also on June 9, 1959, the petitioners were served with an SEC motion for an order under Rule 34, re-

quiring the petitioners to produce for inspection certain generally described books and records. [R. p. 121.]

In the notice of motion, also served at the same time, the date and hour that the matter was to be presented was left blank. This matter also was ordered to be heard on the following day, June 10, 1959. Both this and the preceding matter were disposed of by the same order. [R. p. 119.]

The petitioners had instituted an action in the United States District Court for the District of Columbia for the purpose of having subpoenas issued from that court for the taking of other depositions in the District of Columbia, in connection with this case. A copy of one of those subpoenas may be found in the record at page 88. Notice was given that the depositions would be taken in Washington, D. C. on June 16, 1959.

On June 12, 1959 there was filed in the Los Angeles District Court, a document labeled in part, as follows:

> "Motion of Securities and Exchange Commission for Order that Depositions of Philip A. Loomis, Jr., Walter G. Holden, Robert Block, Charles E. Shreve and Robert S. Plotkin Shall Not Be Taken", etc. [R. p. 80.]

No notice of motion was served or used in connection with the foregoing motion. There was no affidavit or evidence of any sort presented by the SEC in support of the proposed motion. In the absence of any evidence or proof, and in the absence of any prayer or request therefor, the trial judge *ex parte* issued an "Order to Show Cause" [R. p. 78], returnable on June 22, 1959, and also in the absence of any prayer, request or evidence in support thereof, issued an or-

der staying the depositions, noticed for June 16, 1959, until the matter could be heard by the court on June 22, 1959. At the hearing on June 22, 1959, no evidence was presented by the SEC, but evidence was presented by the petitioners. A document entitled "Defendants' Response to Rule and Order to Show Cause", verified by David Farrell, was submitted in opposition to the SEC motion [R. p. 89], together with a supporting affidavit by counsel for these petitioners. [R. p. 110.]

Under date of June 23, 1959, disregarding the affidavits of the petitioners, and in the absence of any evidence to support his order, the trial judge issued an order prohibiting the depositions sought, and directing that the subpoenas *re* depositions issued by the United States District Court for the District of Columbia, should be quashed. [R. p. 115.]

The importance and materiality to the petitioners of the evidence which they sought to obtain by the taking of these depositions before trial is outlined in the "Defendants' Response to Rule and Order to Show Cause" [R. p. 89] verified by David Farrell, and by the "Affidavit of Morgan Cuthbertson" [R. p. 110] both of which were filed with the district court judge before his ruling. The prime purposes of the intended depositions were to prove that never in the history of the SEC had it ever accepted for registration, or considered available for registration, single trust deeds or mortgages, such as the petitioners were dealing in; that under the Securities Act of 1933, and the rules and regulations of the SEC it would be impossible to register them; that the SEC had no procedure to adjudicate whether the private offering exemption or in-

trastate exemption, claimed by the petitioners, was or was not available; and that such exemptions became effective without any action of the SEC.

Being denied the right to take these depositions, the petitioners were unable to offer other proof of these important defenses.

Prejudicial Errors of the Trial Judge in Admitting Exhibits Offered by the SEC.

We have scheduled in the appendix hereto, commencing on page 103, a list of about 100 exhibits offered by the SEC and admitted into evidence by the trial judge, overruling proper objections made by the petitioners, which exhibits were irrelevant and immaterial to the issues and which were lacking identification, verification or foundation, many of which were shown to be erroneous and misleading, or containing unsupported conclusions of fact and of law. Allowable space in this petition does not permit us to set forth here a detailed exposition with reference to these many exhibits. We will mention a few. We invite this Court to select at random any of the items shown on the schedule, having in mind that the issues framed by the amended and supplemental complaint related to events which allegedly occurred prior to October 8, 1958. [R. p. 12.]

We would call specific attention to Plaintiff's Exhibit 77, which so impressed the Court of Appeals that it set forth in the margin of its opinion of November 23, 1960, in support of its conclusion of fraud, a quotation of the district court's findings with respect to this Exhibit 77. The offer of this document, a schedule prepared by SEC investigators, appears at page 2808 of the transcript, followed by a detailed objec-

tion to the document. Commencing on the bottom of page 2810 and carrying over to page 2811 appears the admission of counsel for the SEC that

> ". . . to the extent that even the characterizations which we made, which appear in the schedule, are inconsistent with the testimony in the record or with whatever evidence the defendants may bring forward from the original records of Los Angeles Trust Deed & Mortgage Exchange, the Commission agrees that the schedule may be modified accordingly."

The undisputed testimony offered by the defendants was that there was no truth whatever either in the theory or conclusions represented by that exhibit. [Tr. p. 1656.]

Yet that document was accepted by the court of appeals as affording proof that the petitioners had defrauded some of its customers. It should not have been considered as evidence.

We also direct the Court's attention to the obvious errors in receiving in evidence Plaintiff's Exhibits 59, 80, 81, 82 and 88, without any identification or foundation. (p. 103, Appen. *infra.*)

We wish the Court to observe that the proof and foundation collapsed completely with respect to the schedules prepared by the SEC investigators and received into evidence as Plaintiff's Exhibits 96, 97, 98, 99 and 100 (p. 103, Appen. *infra*) when the appraiser for the building and loan associations, called by the SEC, testified that the appraisals made by those companies, and assumed by the SEC to represent market value, did not represent market value but a substantially lower valuation. [Tr. pp. 2750:15 to 2752:8.]

2. Did the Securities and Exchange Commission Have Authority to Maintain This Action and Did the Federal Court Have Jurisdiction?

The significance of the issues in this case involves the question of the Securities and Exchange Commission assuming jurisdiction of the multi-billion dollar home mortgage and trust deed field. Mortgages and trust deeds have heretofore been considered to be things other than "securities", as that term was defined by Congress in Section 2(1) of the Securities Act of 1933 (15 U. S. C. 77b(1)). The court of appeals, as a case of first impression, now holds that trust deeds as used to finance the purchase of individual homes, and as dealt in by the petitioners, are "investment contracts" and therefore "securities" of which the Securities and Exchange Commission has jurisdiction.

The learned judges of the court of appeals, we believe, fell into the error of assuming that this court had announced two separate tests for what constitutes a "security" in the two cases of *SEC v. Joiner*, 320 U. S. 344 (1943) and that of *SEC v. W. J. Howey Co.*, 328 U. S. 293 (1946). A careful reading of the opinions in these cases leads us to conclude that the *Howey* case which followed the *Joiner* case was intended as a further explanation and exposition of rule announced in the earlier case, and not as a separate and different definition or test. This conclusion is supported by the fact that the evidence in the *Joiner* case fits comfortably into the more exact formula of the *Howey* case. That formula is an accurate description of the status of an investor who invests his money in the capital stock of the usual publicly financed commercial corporation, which was the sort of enterprise

which was principally intended to be supervised when the Securities Act of 1933 was enacted.

In the clear case of the conventional security buyer, not only at the time of investment but throughout the period of his stock ownership, the following relationship continuously existed: the investor was involved in a common enterprise with all other stockholders similarly situated, and each was wholly and solely dependent upon the officers and directors to do whatever might be necessary to make the business of the company profitable; it was never contemplated that the stockholder would assume any activity in the management of the business.

"The test", said this court, in the *Howey* case at pages 300, 301, "is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others."

Neither of these elements of common enterprise or sole reliance existed in the relationship between the petitioners and their customers. In this lengthy trial, only one customer of the petitioners was called as a witness, a Mr. James West, whose testimony made it clear that he was not involved in any common enterprise with any other customer, and who emphatically did not rely solely, or at all, upon the petitioners or anyone else, but who, on the contrary, assumed active charge by repeatedly rejecting trust deeds sold to him by the petitioners. [Tr. pp. 232 to 265.]

It can be seen that there can be no common enterprise between a person who buys a trust deed executed by a home owner on a particular residence, and another person who buys a trust deed executed by another home owner on another separate residential property. One

might prove to be entirely trouble-free, and the other might require foreclosure for delinquency. The incidents of one would have no effect on the other.

With reference to the element of sole reliance, the duties, obligations and responsibilities of the customer with reference to his trust deed were prominently displayed on the brochures distributed to all customers and prospective customers. No customer claimed he was unaware of these duties, obligations and responsibilities.

We are mindful that this court will normally not review any question of fact sustained by the opinion of the district court and the court of appeals. We feel it necessary, however, to declare that if any customer relied solely upon the petitioners or anyone else to do everything necessary to make his investment profitable (and there is no evidence that any customer did solely rely on the petitioners), he was adequately, repeatedly and emphatically warned that he was to place no such reliance and that it was necessary for him to actively participate in the incidents in the trust deeds which he purchased.

We ask that the court examine Plaintiff's Exhibit 32. a brochure, which in the respects herein indicated, has been used by the petitioners for distribution to its customers and prospective customers consistently since February 1959. At the bottom of the inside cover the prospective customer received this notice:

> "We do not either expressly or by implication guarantee that any customer will not lose on his investment, nor do we undertake or guarantee to protect any customer from loss . . . We do not

'pay interest'. All 10% earnings which accrue to a customer come to him from the trust deed(s) which he purchases."

On page 3 prominently in the middle of the page appears the following statement:

"The customer, however, is the sole owner of each trust deed paid for in full, and has all of the privileges, responsibilities and incidents of ownership, including the right to make all decisions relative thereto."

On page 8 appears the following:

"In 1933, the California legislature enacted Section 2924c of the Civil Code. This section was re-enacted in 1935 and amended in 1949 and 1951. The provisions of this section now permit an owner or lender under a subordinated Trust Deed, at any time within 3 months of the recording of a Notice of Default under a prior Trust Deed, to pay up the obligation in default on the prior Trust Deed and thereby reinstate it. Thus, the beneficiary under a second Trust Deed may 'cure' the default of a first Trust Deed and place it back in good standing—it is not necessary to pay it off in full.

"In the event a second Trust Deed holder advances money under the provisions of said Section 2924c of the California Civil Code, he may add such sums paid by him to the indebtedness secured by his second Trust Deed and proceed to foreclose it if the property owner does not reimburse him. Obviously this gives him great protection in his position.

> "The only uncertainty in Trust Deed ownership lies in the fact that if the indebtedness represented by the Trust Deed is not paid, it may be necessary for the Trust Deed owner to foreclose, and to take title to the property. If the property is worth more than the amount owing on the Trust Deeds, the Trust Deed owner may even gain on the transaction. If it is worth less, he may lose. However, our experienced appraisal of each property minimizes this possibility."

Exhibit "U" is a specimen of the usual trust deed form employed. An examination of it will disclose that the trustor owes many duties and obligations to the owner of the trust deed which the owner must observe and enforce for himself. This should demonstrate conclusively that the purchaser of trust deeds was expected to participate actively in the incidents relative thereto and that he had no right or justification to expect that the petitioners or anyone else would undertake to do everything for him.

Thus, within the ruling of this court in *SEC v. W. J. Howey Co.*, 328 U. S. 293, there was no "investment contract" and no "security" involved in the operations of the petitioners. There being none, the SEC had no authority to maintain this action, and the district court had no jurisdiction of it except to dismiss it.

3. Does the Decision of the Court of Appeals in This Case Conflict With the Applicable Decisions of This Court as Announced in the Case of Gordon v. Washington, 259 U. S. 30, and Killeam v. Maryland, 312 U. S. 377, With Respect to the Circumstances Where It Is Declared Improper to Appoint a Receiver?

In *Gordon v. Washington, supra,* this court reversed a decision appointing a receiver, saying at page 37:

> "There is no occasion for a court of equity to appoint a receiver of property of which it is asked to make no further disposition."

This Court also stated:

> "A federal court of equity will not appoint a receiver where the appointment is not ancillary to some final relief which is appropriate for equity to give."

At page 39 of the same case this Court also said:

> "Even where the bill of complaint states a cause of action in equity, the summary remedy by receivership, with the attendant burdensome expense, should be resorted to only on a plain showing of some threatened loss or injury which the receivership would avoid."

The case of *Killeam v. Maryland,* 312 U. S. 377, as we read it, is on all fours with the case at bar. There, as here, the receivership was sought ". . . not as a means to an end but as an end itself." (p. 380.)

This Court also stated at page 381:

> "This court has frequently admonished that a federal court of equity should not appoint a receiv-

er where the appointment is not a remedy auxiliary to some primary relief which is sought and which equity may grant."

It is submitted that the decision of the court of appeals is in conflict with the foregoing statements, where the receiver was appointed (p. 91, Appen. *infra*):

". . . to maintain in status quo the assets of the appellants and the respective purchasers of the second trust deeds until such time as appellants can comply with the law, or dissatisfied trust deed holders or other creditors may take the necessary steps to prove by regular and ordinary methods that the several appellants are insolvent and/or unable to meet their obligations."

The receiver is thus made an advance agent for the bankruptcy court, who has no authority but to await possible action by creditors to open the doors of the bankruptcy court, where the undisputed evidence showed at the time of the judgment of the district court the petitioners were solvent and fully able to meet their obligations. [See financial statement of September 25, 1959, where there is shown a net worth of $904,631.19, R. pp. 194-209.]

The judgment of the district court, which was affirmed in these respects by the court of appeals, also directed the receiver to "adjust and protect the equities" of investors who are not parties to this action (p. 44, Appen. *infra*), and to "arrange for and have carried out an audit of the books, records and accounts of said defendants" (p. 45, Appen. *infra*), and "to arrange for and have carried out an evaluation of the assets" of the defendants (p. 45, Appen. *infra*.)

There is no authority in the law for a receiver to perform any such activities. These are not "means to an end", but ends in themselves within the prohibition announced by this court in the quoted cases.

4. Where the Authority of the SEC to Bring Actions in the District Court Is Specified in Section 20(b) and (c) of the Securities Act of 1933 (15 U. S. C. 77t(b) and (c)), May the SEC Disregard the Limitations so Imposed and Bring an Action Under the Broader Provisions of Section 22(a) of the Securities Act of 1933 (15 U. S. C. 77v(a)), Which This Court Held in Deckert v. Independent Shares, 311 U. S. 282 Was Intended as a Remedy for Investors?

The decision of the court of appeals of November 23, 1960 (p. 56, Appen. *infra*) declares:

> "The jurisdiction of the court below rests upon section 22(a) of the Securities Act of 1933 (15 U. S. C. 77v(a)) as to three counts and upon section 27 of the Securities Exchange Act of 1934 (15 U. S. C. 78(aa)) as to two counts."

Later in the same opinion (p. 88, Appen. *infra*), the following appears:

> "Thus, we see that 15 U. S. C. 77t(b) (and the substantially identical 21(e) of the Securities Exchange Act of 1934 (15 U. S. C. 78u(e)) is the basis of the authority for the SEC's suit herein."

Thus it appears that on one page of its opinion this Court declares that this action was brought under 15 U. S. C. 77v(a) of the Securities Act of 1933. On the later page the opinion says the action was brought under 15 U. S. C. 77t(b).

This is inconsistent and confusing. The court of appeals is carrying water on both shoulders. If we take the second statement that 15 U. S. C. 77t(b) "is the basis of the authority for the SEC's suit herein" as the court of appeals declares, an examination of that statute will affirmatively show the SEC has no right to request a receiver, for the statute only authorizes an injunction or mandamus. If Congress had intended that Section 22(a) (15 U. S. C. 77v(a)) should spell out the authority of the SEC to invoke "all suits in equity and actions at law," then Section 20(b) (15 U. S. C. 77t(b)) becomes surplusage. Why should Congress authorize the SEC to institute injunction and mandamus actions in Section 20(b) (15 U. S. C. 77t-(b)) and at the same time grant to the SEC the authority to take any legal or equitable action in Section 22(a) (15 U. S. C. 77v(a))?

What we consider to be proper statutory construction leads us to believe that Congress did not intend that the SEC should have the drastic and ruthless power to take over the property and assets of an adversary by receivership and thus to render the adversary powerless to prosecute an appeal by drying up the funds necessary to prosecute an appeal to higher courts or to otherwise protect itself.

The opinion of the court of appeals does not justify the appointment of a receiver on either the grounds of fraud or insolvency. Indeed, in its opinion of November 23, 1960, it carefully avoids making any determination of insolvency. At page 91, Appen. *infra*, it declares that after the appointment of the receiver

> ". . . dissatisfied trust deed holders or other creditors may take the necessary steps to prove by reg-

ular and ordinary methods that the several appellants are insolvent and/or unable to meet their obligations."

The evidence in the case did not show that the petitioners were insolvent or in danger of insolvency at the time of the district court judgment. Indeed, the latest financial statement received in evidence showed that they had an excess of assets over liabilities of some $904,631.19. [R. p. 200.]

While the court of appeals did find ". . . sufficient evidence in the record to support the trial court's findings of fact and conclusions of law that the appellants are guilty of unlawful and deceitful and fraudulent acts" (p. 89, Appen. *infra*), the evidence referred to does not sustain that conclusion, nor is there any evidence of any threat of continued unlawful or fraudulent acts to justify the appointment of a receiver.

The same court of appeals, in an earlier decision, *American Manganese Steel Co. v. Alaska Mines Corporation*, 250 Fed. 614, sustained an order of a district court denying a receiver and declared:

> "It may be conceded that the appellant presented to the court a strong prima facie showing of fraud . . . but that was not all that was necessary to entitle the appellant to the appointment of a receiver. It was required to go further, and show the necessity of the appointment for its protection while the suit was pending in the court below. To establish the necessity of the appointment of a receiver in an equitable suit such as this it must be shown by clear proof that there is imminent danger that unless a receiver is appointed the property

involved will deteriorate in value or be wasted and that the plaintiff will thereby suffer irreparable loss. And there can be no irreparable loss if the defendant is solvent and able to satisfy the plaintiff's demand."

This, we submit is a correct statement of the law.

5. There Is No Provision in the Federal Law to Require a District Court Judge to File Counter-Affidavits to an Affidavit Charging Him With Bias and Prejudice Under 28 U. S. C. 144, nor That the Question of Bias and Prejudice Should Be Heard and Determined by the Presiding Judge of His Court. The Only Authorized Procedure to Test the Sufficiency of Such Bias and Prejudice Is by Appeal From a Final Judgment or Some Other Appealable Order.

In the opinion of the court of appeals of November 23, 1960, the court purports to recognize and authorize such counter-affidavits and a determination by the presiding judge. (p. 73, Appen. *infra.*) This is contrary to the ruling made by this court in *Berger v. United States,* 255 U. S. 22, the ruling by the court of appeals for the sixth circuit in the case of *Albert v. United States,* 283 F. 2d 61 (1960), and the ruling by the court of appeals for the seventh circuit in *Korer v. Hoffman,* 212 F. 2d 211 (1954).

Conduct by a judge during the trial may also be considered to invalidate his judgment if bias and prejudice is thereby shown. Such is the holding by the court of appeals for the District of Columbia in *Whitaker v. McLean,* 118 F. 2d 596 (1941), and by the court of appeals for the sixth circuit in *Knapp v. Kinsey,* 232 F. 2d 458 (1956).

6. A Judgment Should Be Reversed if It Was Rendered by a Trial Judge Who Is Shown to Have Been Biased and Prejudiced Before the Trial by Affidavit Filed Under 28 U. S. C. 144, or Who During the Trial Exhibited Such Hostility as to Demonstrate Bias and Prejudice, Irrespective of the Apparent Weight of the Evidence in the Case.

The opinion of the court of appeals of November 23, 1960, in that portion appearing on page 74 of the Appen. *infra,* tacitly concedes evidence of bias and prejudice on the part of the trial judge during the trial but waives it aside because of its conclusion that the ". . . evidence presented to us by the record herein which fully generally supports the court's findings and judgment."[4]

We submit that the evidence amply sustains the bias and prejudice of the trial judge, as shown by the timely affidavit filed in advance of trial [R. p. 66] and by the prejudicial conduct outlined in this section of the brief under the heading "First Question" *supra,* and by the affidavit ordered to be sealed by the court of appeals. We also contend that if the bias and prejudice is shown, the apparent weight of the evidence is immaterial, and the judgment is contrary to the rulings announced by the Court of Appeals for the District of Columbia in the case of *Whitaker v. McLean,* 118

---

[4]The incident to which the opinion refers is that disclosed by the affidavit mentioned as footnote 3 on page 8 of this petition, which was ordered to be sealed by the court. For this reason we are unable to present it as a part of this record. We ask that this court direct the court of appeals to permit that the affidavit mentioned be made part of this record. It will support the statement appearing on the same page of this brief, with respect to the physical assault coupled with the threat to impose bodily harm on one of petitioners' counsel, made by the trial judge.

F. 2d 596 (1941), and by the Court of Appeals for the Sixth Circuit in the case of *Knapp v. Kinsey*, 232 F. 2d 458, 465, wherein it was declared:

"One of the fundamental rights of a litigant under our judicial system is that he is entitled to a fair trial in a fair tribunal, and that fairness requires an absence of actual bias or prejudice in the trial of the case. In re Murchison, 349 U. S. 133, 136, 75 S. Ct. 623, 99 L. Ed. 942; Talbert v. Muskegon Construction Co., 305 Mich. 345, 348, 9 N. W. 2d 572. If this basic principle is violated, the judgment must be reversed. In re Murchison, supra; Berger v. United States, 255 U. S. 22, 41 S. Ct. 230, 65 L. Ed 481; Moskun v. United States, 6 Cir., 143 F. 2d 129, 130; N. L. R. B. v. Phelps, 5 Cir., 136 F. 2d 562.

"Bias or prejudice on the part of a judge may exhibit itself prior to the trial by acts or statements on his part. Or it may appear during the trial by reason of the actions of the judge in the conduct of the trial. If it is known to exist before the trial it furnishes the basis for disqualification of the judge to conduct the trial. Section 144, Title 28, U. S. Code. This section provides: 'Whenever a party to any proceeding in a district court makes and files a timely and sufficient affidavit that the judge before whom the matter is pending has a personal bias or prejudice either against him or in favor of any adverse party, such judge shall proceed no further therein, but another judge shall be assigned to hear such proceeding.' This statutory provision is not directly applicable to proceedings wherein the claimed bias or prejudice appears

during the course of the trial. However, there would seem to be close analogy between bias and prejudice which would disqualify a judge from sitting in a judicial proceeding and the bias or prejudice appearing during the course of the proceedings which would render the judgment therein invalid."

It would appear that the court of appeals was convinced of the bias and prejudice of the trial judge in the case at bar, but erroneously concluded that because of the evidence it would not invalidate the judgment. The court of appeals, by its order of October 16, 1959 (p. 29, Appen. *infra*) responded to the affidavit of bias and prejudice filed under 28 U. S. C. 144 in the following language:

> "The Petition for Writ of Prohibition and for Mandamus is denied; there being at this time no sufficient or adequate showing of personal bias or prejudice on the part of the judge trying the action in the District Court."

The court of appeals gave further recognition to the bias and prejudice of the district court judge in its order of January 10, 1961, denying the petitioners' petition for a rehearing (pp. 97-98, Appen. *infra.*) The trial judge who rendered the judgment is described therein as Judge "A". The court of appeals, in the opinion of January 10, 1961, had the following to say:

> "We would not condone an effort to shop for a judge pleasing to a party. But on the other hand we do say at this juncture the better course of wisdom would be for Judge "A" to let some other judge take over the cases. Judge "A" just should

not feel it his duty, after he has some inkling that a violent attack has been made upon him, to preside over the cases as long as some other judge can be found, provided he is at a good stopping point. And we think he is there. Since Judge "B" apparently no longer desires to handle the cases, perhaps a third judge could be found.

"We have not said that affidavits for disqualification could not be filed at this juncture in this, the original case, or in the companion cases (which have not been before us except as they are here imported.)

"While a mere verified conclusion that a judge is biased and prejudiced is not enough under the federal system to disqualify, still if the affidavit is sufficient on its face it is not open to the trial judge to file a traverse. We suggest possibly on reconsideration Judge "A" may feel disposed to refer this case and its related cases to the Chief Judge of the District for reassignment.

"It is suggested that the filing of an affidavit of disqualification may not be necessary and that Judge "A" will see fit to follow the course of Judge McLaughlin, of which we take judicial notice, when he stepped aside after our decision in *Gladstein v. McLaughlin,* 230 F. 2d 762.

"After careful consideration, in our opinion on the merits we held that appellants had a fair trial. But somewhere along the road decorum has faltered.

"We have not ruled that the affidavit which we have sealed is true. We have not determined that

if Judge "A" became provoked on some day he did not have reason to be provoked. We do not know. And we seek to avoid the necessity of finding out."

We submit that under the rulings as announced by the Court of Appeals for the District of Columbia in *Whitaker v. McLean,* 118 F. 2d 596 (1941) and the rulings announced by the Court of Appeals for the Sixth Circuit in *Knapp v. Kinsey,* 232 F. 2d 458, 465, the Court of Appeals should have reversed the judgment of the trial court, and that this court should disapprove the inferential holding made by the Court of Appeals in this case that bias and prejudice can be overlooked if the evidence seems to support the person for whom the judgment is rendered.

The Court of Appeals for the Sixth Circuit, in the case of *N. L. R. B. v. Ford Motor Company,* 114 F. 2d 905, 909 (cert. denied, 312 U. S. 689), announced the rule citing three decisions of this Court when it declared:

> "We may accept as fundamental, the axiom that a trial by a biased judge is not in conformity with due process of law. *Tumey v. Ohio,* 273 U. S. 510, 522, 47 S. Ct. 437, 71 L. Ed. 749, 50 A. L. R. 1243; *Jordan v. Massachusetts,* 225 U. S. 167, 176, 32 S. Ct. 651, 56 L. Ed. 1038; *Ohio Bell Telephone Co. v. Public Utilities Commission,* 301 U. S. 292, 294, 57 S. Ct. 724, 81 L. Ed. 1093."

Wherefore, Petitioners pray that this Court grant a writ of certiorari to review the judgment of the U. S.

Court of Appeals for the Ninth Circuit, dated November 23, 1960, ... F. 2d ....., as modified by its order on petition for rehearing dated January 10, 1961, ..., F. 2d ....., affirming and modifying the judgment of the U. S. District Court for the Southern District of California, dated May 20, 1960.

Respectfully submitted,

MORGAN CUTHBERTSON,

Attorney for Petitioners.

APPENDICES.

PAGE

Appendix I. Court of Appeals Opinion and Order of February 17, 1959, 264 F. 2d 199 1

Appendix II. Court of Appeals Order of October 16, 1959.. 29

Appendix III. District Court Final Judgment of Permanent Injunction and Order Appointing Receiver, Dated May 20, 1960 31

Appendix IV. Court of Appeals Order of June 7, 1960..... 48

Appendix V. Court of Appeals Opinion and Order of July 14, 1960 51

Appendix VI. Court of Appeals Opinion of November 23, 1960 54

Appendix VII. Court of Appeals Order of January 10, 1961 95

Appendix VIII. Section 20(b) and Section 20(c) of the Securities Act of 1933..... 99

Appendix IX. Section 22(a) of the Securities Act of 1933....100

Appendix X. SEC Motion Filed September 2, 1959.....101

Appendix XI. Plaintiff's Exhibits and Objections Noted in Reporter's Transcript 103

APPENDIX I.

Court of Appeals Opinion and Order of February 17, 1959 (264 F. 2d 199)

United States Court of Appeals for the Ninth Circuit.

Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Markets, David Farrell, Oliver J. Farrell, Roy A. Bonner, Thomas Wolfe, Jr. and Stanley C. Marks, Appellants, vs. Securities and Exchange Commission, Appellee. No. 16,245. Feb. 17, 1959.

Appeal from the United States District Court for the Southern District of California Central Division.

Before: Stephens Chief Judge; Healy and Barnes, Circuit Judges.

Barnes, Circuit Judge:

The Securities Exchange Commission (sometimes hereinafter referred to as the SEC) filed a complaint for an injunction against three corporate defendants: Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange, and Trust Deed & Mortgage Markets, to prevent the sale of certain alleged securities.[1]

---

[1]Each corporate defendant was charged in Count I of the original complaint with using the mails and means of transportation in interstate commerce "to sell and offer to sell securities, namely, evidences of indebtedness, investment contracts and receipts for and guarantees of such securities, issued by the defendants . . . arising out of and in connection with the offering for sale and selling by the defendants of promissory notes secured by deeds of trust covering residential and other real estate situated within the State of California, in accordance with an investment plan and program, involving various collateral agreements and undertakings by the defendants" designated as a program through the use of a prospectus and otherwise. (Sec. 5(a) and (c) of the Securities Act of 1933, 15 U.S.C. §77e(a) and (c).)

The same defendants in Count II were charged with a violation of § 17(a)(3) of the Securities Act of 1933, 15 U.S.C.

An answer was filed generally denying all allegations in the original complaint.

Pursuant to order of court duly obtained, the plaintiff filed on October 8, 1958, an Amended and Supplemental Complaint.

Count I was the same in the Amended Complaint as in the original. Count II added the following material facts as having not been stated by defendants to their customers: (e) "the losses sustained by investors"; (f) the sources of the funds used to inventory or "warehouse" notes secured by deeds of trust; (g) the financial condition of the corporate defendants; (h) the

---

§ 77q(a)(3), in that in selling the "securities" herein described, they allegedly engaged "in transactions, practices, and a course of business which operate and would operate as a fraud and deceit upon the purchasers of such securities," specifying ten particular misrepresentations, and in failing to state material facts, *i.e.*, (a) the speculative nature of the investments; (b) the method used in reinvestment, and the lack of certainty as to continuing on this basis; (c) the legal distinctions between first and second deeds of trust; (d) the distinctions between trading in fungible securities listed on regulated national securities exchanges, and the defendants "open market trading."

The same defendants in Count III were charged with obtaining money and property by untrue statements of material facts, as alleged in Count II, a violation of § 17(a)(2) of the Securities Act of 1933, 15 U.S.C. § 77q(a)(2).

The same defendants and some individual defendants in Count IV are charged with using the mails and instrumentalities of interstate commerce to effect sales of securities by deceptive and fraudulent devices, by engaging in the acts described in Counts II and III, and as to the defendants Los Angeles Trust Deed & Mortgage Exchange and Trust Deed & Mortgage Exchange, in using the term "Exchange," an alleged violation of § 15(c)(1) of the Securities Exchange Act of 1934, 15 U.S.C. § 78o(c)(1), and rule, 17 C.F.R. 240.15c1-2.

The same defendants in Count V are charged with use of the mails and means and instrumentalities in interstate commerce to sell such securities described above, without registering as a broker or dealer, in alleged violation of § 15(a) of the Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78o(a).

fact that this action had been brought by the SEC; (k) the background, integrity, and qualifications of the officers and personnel of the corporate defendants.

Counts III and IV in the Amended Complaint were enlarged by reference to and inclusion of enlarged Count II, and Count V remained the same.

Said Amended Complaint also alleged for the first time that the three corporate defendants "have been and now are insolvent and unable to meet their current liabilities, and the funds received . . . by defendants from investors under the 'Secured 10% Earnings Program' have been and are now in jeopardy."

On the same date, October 8, 1958, when the Amended and Supplemental Complaint was filed, the SEC enlarged its demands, by separate petition, demanding a preliminary injunction and the appointment of a receiver. The Amended and Supplemental Complaint prayed for a final judgment restraining the three corporate defendants and their officers from using the mails or any means or instruments of transportation or communication in interstate commerce to sell or offer to sell said securities, "namely, evidences of indebtedness, investment contracts or receipts for or guarantees of such securities, issued by the defendants Los Angeles Trust Deed and Mortgage Exchange, Trust Deed and Mortgage Exchange or Trust Deed and Mortgage Markets," without registering the same, or by use of the misrepresentations previously listed, or without taking steps to prevent the statements made from

being misleading, or by using the word "exchange"; and the appointment of a receiver.

Several affidavits and a supplemental affidavit were filed in support of this motion by the SEC, and affidavits in opposition thereto filed on behalf of defendants.

On October 17, 1958, the district court heard (a) the defendants' motion for an immediate trial; (b) the plaintiff's motion for a preliminary injunction and appointment of a receiver.

Hearing was had and evidence taken on October 17th, 21st, 24th, 27th and 30th, and on November 4th, 6th and 7th, 1958.

Defendants' motion for an immediate trial was granted and trial set for December 9th, 1958. From an examination of the transcript of record, however, it appears that the hearing of the motion for appointment of receiver developed into a full scale hearing of many, if not all, issues raised by the amended complaint and the plaintiff's motions.

On November 7, 1958, the court below issued a preliminary injunction and appointed a receiver. No findings of fact or conclusions of law were made by the district judge, although the court's order provided that it "reserves jurisdiction to amend and supplement the preliminary injunction, and order appointing receiver by definitive findings of fact, conclusions of law, and further order to be settled before the Court on or before November 13th, 1958."

After an order shortening time was made,[2] Findings of Fact and Conclusions of Law were signed and filed on November 12th, 1958.[3]

---

[2]It is noted that the order shortening time required service on defendants' counsel on or before 2:00 P.M. on November 12, 1958, the settlement to be at 3:00 P.M. on that same day. The acknowledgement of service shows that service was effected at 2:38 P.M. on November 12th, 1958, on counsel for certain defendants, and at 2:43 P.M. on November 12th, 1958, on the counsel for other defendants. Thus, as it was expressed by one counsel for defendants, he was given seventeen minutes notice of the settlement of the findings in an eighteen page document. *Cf.* Rules 3 and 7, Local Rules, U. S. Dist. Ct., Southern District of California; Fed. R. Civ. P. 52(b), 65(d).

[3]*Findings of Fact and Conclusions of Law, II—The Investment Plan* reads as follows:

"1. Defendants are in the business of buying notes secured by deeds of trust, principally second deeds of trust, covering residential and other real estate situated within the State of California, and reselling such securities to members of the investing public under the 'Secured 10% Earnings Program' and the 'Secured 10% Reinvestment Program.' An investor may, if he wishes, buy a note and deed of trust outright and make his own collections. Investors, however, are encouraged to leave their notes with defendants for collection; if this is done, defendants undertake to remit by check each month an amount equivalent to 10% 'earnings' on the amount paid in by the investor and to reinvest the balance; or defendants undertake to reinvest all of the money collected from the maker of the note. As a medium for reinvestment, the investor is sold another note, the title to which is retained in one of the corporate defendants. The investor, in effect, buys the second note on the installment plan. The investor is charged with the purchase price of the second note, together with interest on his unpaid balance at 10%, and is credited with the amounts paid in from time to time. The defendants represent that 10% 'yield' or 'earnings' can be obtained without risk, and defendants undertake to screen, process, collect and repurchase or resell the notes and deeds of trust so sold to investors.

"2. The operations of defendants involve the sale of securities in at least three senses. The note secured by the deed of trust

The November 12th, 1958 order for preliminary injunction and order appointing receiver contained an order that it "be and it is entered as of November 7th,

---

delivered to the investor is, as a note and evidence of indebtedness, a security by express definition [note 2]; similarly, the receipt issued by defendants evidencing the receipt of the investor's funds and the deposit of such funds by defendants in a special trust account, [note 3] pending selection by defendants and acceptance by the investor of a note and deed of trust, is also a security by definition; and the sale of the note and deed of trust, accompanied by the collateral undertakings to screen, process, select, service, collect, repurchase or resell, in accordance with the general plan of investment held out to the investor, in the light of the express and implied representations made by defendants, constitutes the sale of an investment contract within the statutory definition.

"3. The defendants are selling not mere individual isolated notes; they are selling neatly done-up packages of rights and expectations, by virtue of which the investor gets not only a note, a deed of trust, a title policy, a fire insurance policy and an assignment, but the representation and assurance that the loan has been selected, screened and processed by defendants to meet the investor's individual investment needs; that defendants will service and collect the loan, and if need be handle foreclosure thereof; that all the investor has to do is sit back and receive a monthly check equivalent to 10% on his investment; and that, if the investor is dissatisfied or wishes to withdraw, the corporate defendants will repurchase or arrange for the resale of the note and deed of trust. There is an implied guarantee against loss of principal and of a fixed rate of return, and, if the investor so elects, the defendants undertake to keep the [money] coming in continuously reinvested. The defendants recognize that very few, if any, of the investors, many of whom reside at great distances from the State of California, where the makers of the notes reside and where appraisals, collection and foreclosure proceedings must be carried out, have any knowledge of, or in fact any interest in, the solvency of the makers of the notes or the quality of the underlying security. On the contrary, it is implicit in the defendants' program that investors must rely upon defendants in order to realize the promised 'secured 10% earnings' and the rapid pyramiding of their investments which the defendants hold out as inducements to investors.

"4. No registration statement under the Securities Act of 1933 has been filed or is in effect in respect of the securities offered by the defendants despite a clear written warning by the Commission that such registration is required.

"5. The Court finds that defendants' 'Secured 10% Earnings Program' and 'Secured 10% Earnings Reinvestment Program'

1957," (One year before the date of the original restraining order) and "is intended by the Court to supersede the Preliminary Injunction and Order Appointing

---

constitute a single and integrated plan and scheme of investment which has been and is being held out to members of the investing public as a means by which investors may rely upon the ability, skill, industry and capital resources of the defendants to bring such investors an assured and certain 10% earnings and 'automatic capital appreciation,' without effort insofar as investors are concerned.

III—Evidence of Fraud

"1. The defendants have introduced into the mails and the channels of interstate commerce many thousands of brochures, and other selling literature describing their 'Secured 10% Earnings Program' and 'Secured 10% Earnings Reinvestment Program,' in addition to advertising their investment plan through the media of newspapers, periodicals, radio and television. The admitted purpose of this mass advertising of defendants' investment program has been to 'condition' the minds of members of the investing public throughout the United States and foreign countries. By these means the defendants have led investors to rely upon the following, among other representations: . . ."

[Here appears (a) to (n) precisely as alleged in the Amended Complaint, except that the words "secured 10% Earning Accounts" are added to (h), and the Exchange is found to have been maintained by Los Angeles Trust Deed & Mortgage Exchange rather than by all three defendants in (i).]

"The evidence establishes that the foregoing representations singly and cumulatively are untrue, deceptive and misleading.

"2. In so 'conditioning' the minds of investors and in leading them to believe that the defendants' 'Secured 10% Earnings Program' and 'Secured 10% Reinvestment Program' constitute a safe, secure and certain method of realizing 'earnings' of 10%, together with a means of pyramiding small investments to enormous totals through defendants' 'automatic reinvestment program,' the defendants have carefully and artfully avoided disclosure of the following, among other material facts, concerning their investment plan:

"a) The speculative nature of investments under the defendants' 'Secured 10% Earnings Program,' 'Secured 10% Earnings Accounts,' or 'Secured 10% Earnings Reinvestment Program."

"b) The method used in arranging for the monthly reinvestment of investors' funds under the 'Secured 10% Earnings Reinvestment Program,' or the lack of certainty that monthly collections can be continuously reinvested in prime deeds of trust, in order to establish a

Receiver signed by the Court on that date." (sic) So far as we are informed from the record before us, this clerical error has never been corrected.

---

capital appreciation measured by a yield of 10% compounded monthly over any substantial length of time.

"c) The distinctions and differences between first deeds of trust and second deeds of trust.

"d) The distinctions and differences between trading in fungible securities listed and registered on national securities exchanges offering auction markets in such securities, subject to regulation and control by such exchanges and by Federal and State regulatory agencies, including the Securities and Exchange Commission, and the 'open market trading' on an option basis in notes secured by deeds of trust conducted by defendants through Los Angeles Trust Deed & Mortgage Exchange.

"e) The losses sustained by investors under the 'Secured 10% Earnings Program' or 'Secured 10% Earnings Accounts.'

"f) The source of funds used by defendants to inventory or 'warehouse' notes secured by deeds of trust.

"g) The financial condition of Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange and Trust Deed & Mortgage Markets.

"h) The action brought by the Securities and Exchange Commission in this Court charging the defendants with violations of the registration and anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934, and the defendants Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange and Trust Deed & Mortgage Markets with violations of the broker-dealer registration requirements of the Securities Exchange Act of 1934.

"i) The background, integrity or qualifications of the officers or directors of or personnel employed by the defendants Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange or Trust Deed & Mortgage Markets, including the fact that C. W. Cannon, former comptroller of Los Angeles Trust Deed & Mortgage Exchange, has been convicted of grand theft and disbarred from the practice of law.

"3. The defendants' deception of investors has met with marked success. During the last fiscal year Los Angeles Trust Deed & Mortgage Exchange received more than $5,000,000 in investors' funds, at the time of the hearing on the motion the Company was receiving in excess of $1,000,000 monthly, and as

The order of November 7, 1958 granted a preliminary injunction and appointed a receiver without the making of any findings of fact or conclusions of law. This violated the rules of the district court in at least three particulars: (1) it did not set forth the reasons for its issuance; (2) it was not specific in its terms; (3) it did not describe in reasonable detail, but merely by reference to the complaint, the acts or acts sought to be restrained. Rule 65(d), Fed. R. Civ. P.; *Mayo v. Lakeland Highlands Canning Co.*, 1940, 309 U. S. 310, 316. Appellants filed a timely appeal from the order

---

of September 30 1958, the Company had been entrusted by investors with $1,158,877, which remained uninvested.

"4. The list of misrepresentations made by the defendants is seemingly endless. It is important, however, for the Court to make specific mention of at least two such areas of misrepresentation.

"5. *First:* The defendants have represented and indeed continue to represent that funds received from investors are segregated and held in a separate trust account. This representation is false. No such trust account has existed since March 1957. On the contrary, since defendants' investment scheme began to assume substantial dimensions, the defendants quickly, but without informing investors, abandoned the fiction of segregating investors' funds in a special trust account, and thereafter commingled such funds with the general funds of Los Angeles Trust Deed & Mortgage Exchange, and have since used them indiscriminately for general corporate purposes, including, contrary to defendants' express representation to investors, the inventorying or 'warehousing' of deeds of trust, and the financing of debit balances of investors under the 'automatic reinvestment program.' [note 4] For example, as of February 28, 1958, Los Angeles Trust Deed & Mortgage Exchange had been entrusted with $329,375, which at that time remained uninvested. The entire balance of the Company's bank account on that date was only $31,982. Similarly, as of September 30, 1958, the Company had been entrusted with $1,158,877 in cash by investors, but the Company had only $1,046,537 cash in bank, and there were *current* accounts payable totaling $355,948. This commingling and misappropriation of funds entrusted to the defendants con-

granting the preliminary injunction and the appointment of the temporary receiver. Fed. R. Civ. P. 73(a) and (b).

Appellants applied to a judge of this Court for a temporary stay of the order for preliminary injunction and the appointment of a receiver. This was temporarily granted on November 13th, 1958, until the matter could be heard by the same panel of judges who heard this appeal. As a result of such hearing, an order staying the preliminary injunction and appointment of receiver was issued, and a further restraining order re-

---

stitute a serious and indefensible breach of trust. Supplementing this finding of breach of trust, the Court must find on the evidence that as early as February 28, 1958, and continuing until the present time, the corporate defendants have been and are insolvent at least in the sense that as trustees they have been and are unable to meet their obligations to investors. There is, moreover, substantial evidence to the effect that the corporate defendants have been and are insolvent in the bankruptcy sense.

"6. *Second*: The representation that the defendants Los Angeles Trust Deed & Mortgage Exchange maintain facilities for and conduct 'open-market trading' in trust deeds and mortgages on the same basis that the leading stock exchanges function and operate is a complete misrepresentation of the facts. The so-called 'open board trading' by the defendants Los Angeles Trust Deed & Mortgage Exchange has meant nothing more than that the defendant obtains 'options' on deeds of trust which David Farrell, President and Chairman of the Board of Los Angeles Trust Deed & Mortgage Exchange, described as 'trash' and then attempts to sell the trust deeds in a *negotiated* transaction at a price above the option price. Moreover, although defendants' current brochure contains an elaborate description of the 'open-market trading' in trust deeds, by means of which defendants purport to 'stabilize' the market in such instruments for the benefit of investors, for at least the last seven months the 'trading board' has been used only as a partition dividing defendants' new offices. The entire concept of 'open-market trading' in trust deeds as represented to investors has been and is a mere sham and pretense."

stricting defendants was issued, and other orders necessary for a speedy hearing of this appeal were made."

"ORDER STAYING PRELIMINARY INJUNCTION AND APPOINTMENT OF RECEIVER AND RESTRAINING ORDER

"Upon Application of defendants and appellants, and good cause having been shown therefor,

"IT IS HEREBY ORDERED that the two several orders of the United States District Court for the Southern District of California, one dated November 7, 1958, and providing for a preliminary injunction and the appointment of a receiver; and the second dated November 12, 1958; ordered entered as of November 7, 1957 (sic), intended to supersede the original Preliminary Injunction and Order Appointing Receiver dated November 7, 1958, are, and each of them is, in each and every particular stayed until the hearing of the appeal on its merits heretofore filed from said orders, and each of them, and until the further order of this Court.

"AND IT IS FURTHER HEREBY ORDERED that the defendants and appellants, and each of them, their officers, agents, servants and employees, are hereby restrained from making any withdrawal of funds from the assets and/or trust funds of the corporate defendants and appellants, other than in the regular and ordinary course of business;

"AND IT IS FURTHER HEREBY ORDERED that the record and briefs of each party on the pending appeal may, if counsel desire, be typewritten;

"AND IT IS FURTHER HEREBY ORDERED that the appeal on the merits is hereby set down specially for hearing at 9:45 A.M. on Friday, January 23, 1959, at the courtroom of this Court of Appeals, located in the Federal Building at Los Angeles, California;

"AND IT IS FURTHER HEREBY ORDERED that the Appellants' Opening Brief shall be served and filed on or before December 15, 1958; that Appellee's Brief shall be served and filed on or before January 5, 1959, and that Appellants' Reply Brief, if any, shall be served and filed on or before January 13, 1959.

ALBERT LEE STEPHENS
Chief Judge
WILLIAM HEALY
Circuit Judge
STANLEY N. BARNES
Circuit Judge

Dated: November 17, 1958
Endorsed:
FILED
November 17th, 1958
By: Stanley N. Barnes
Judge, U. S. Court of Appeals"

On December 14, 1958, appellants filed below their answer to plaintiff's amended and supplemental complaint, raising the question of jurisdiction, denying generally all allegations and raising four affirmative defenses.

Before we consider specifically the points relied on by appellants on this appeal, we comment generally on certain facts disclosed by the record.

(1) The SEC has alleged its causes of action against three corporate defendants: Los Angeles Trust Deed & Mortgage Exchange; Trust Deed & Mortgage Exchange; and Trust Deed & Mortgage Markets. There is no testimony that Trust Deed & Mortgage Markets, a corporation, has sold anything or offered to sell anything, or has any assets or liabilities or ever has had them, or has ever done any business. There is no testimony that Trust Deed & Mortgage Exchange has sold anything, although in the brochures in evidence, its name was used and it offered to sell. The *Los Angeles* Trust Deed & Mortgage Exchange has both sold and offered to sell.

(2) The SEC has alleged in its amended complaint that these same three corporate defendants "have been and are now insolvent and unable to meet their current liabilities, and the funds received and being received by defendants from investors under the 'Secured 10% Earnings Program' have been and are now in jeopardy."

In appellee's brief there appears the statement: "In any event, we have seen that LATD is insolvent in that it is unable to meet its debts as they mature."

It is of interest to note that despite such contention in the brief as to the one corporate defendant, and the

allegation in the complaint as to *each* of the three corporate defendants, *there is no direct and positive finding of insolvency as to any defendant made by the court below*, although there is a finding that "the corporate defendants have been and are insolvent *at least in the sense that as trustees they have been and are unable to meet their obligations to investors.* There is, moreover, substantial evidence to the effect that the corporate defendants have been and are insolvent in the bankruptcy sense." [Emphasis added.]

The reason no such clear-cut finding of insolvency was made is crystal clear. No evidence appears in the record to substantiate such a finding—in fact little creditable evidence exists to lend it support. The expert for the SEC admitted on cross-examination that the net worth of the Los Angeles Trust Deed & Mortgage Exchange, *i.e.*, the excess of assets over liabilities, showed a positive net worth for each of the four months preceding the hearing (namely, June, July, August and September 1958) of between $131,000 and $193,000. The larger figure was the last month's net worth. An attempt was made by SEC experts to re-evaluate certain assets of the Los Angeles Trust Deed & Mortgage Exchange by applying an arbitrary write-down figure of thirty to forty percent discount below the face amount of the notes involved, because second trust deeds are bought and sold, generally, at a discount. No attempt was made (nor was it possible by reason of time limitations) by SEC representatives to determine what the actual market value of the trust deed notes were, nor the actual discount at which they had been purchased, either (a) by an examination of the records to determine what discount had been involved in the

specific purchases made by defendant Los Angeles Trust Deed & Mortgage Exchange, or (b) by an examination of payments theretofore made on both the first and second deeds of trust (*i.e.*, how "seasoned" they were), or (c) by a physical examination of the value of the security underlying the several trust deeds. There was testimony that the defendant Los Angeles Trust Deed & Mortgage Exchange bought second trust deeds at prices from ten percent to fifty percent below face value. More were bought at a figure approaching the lesser rather than that approaching the greater discount. The SEC's thirty percent deduction was admittedly an arbitrary deduction, not justified by any *facts* in evidence, but solely an opinion or guess as to an average.

The evidence before the court showed that on September 30, 1958 (the last date available before the hearings below) the Los Angeles Trust Deed & Mortgage Exchange had:

Current Assets of	$1,592,153.03
Fixed Assets of	61,595.00
Other Assets of	71,002.10
or Total Assets of	$1,724,750.13

Of the current assets, $1,040,537.34 was in cash. On that same date, it had:

Current Liabilities	$ 370,027.03
Trust Funds	2,464.53
Customer's Accounts	1,158,877.74
Capital, Reserves and Earnings	193,380.83
Total Liabilities of	$1,724,750.13

The $193,380.83 mentioned above is the figure described by Mr. Rheinschild, expert witness for the plaintiff SEC, as the excess of assets over liabilities, that is, the "positive net worth."

Thus, without the benefit of findings or other determinations of whether the money on hand was properly characterized as trust funds or non-trust funds; or whether it had been placed in the proper account; or properly or improperly listed in an account designated as "Customer's Accounts" rather than "Trust Funds"; we can come to but one conclusion—the same conclusion that inferentially was reached by the trial court—there was here no proof of actual insolvency of any corporate defendant.

(3) This is a most unusual case in that there is no evidence in the record of any *loss* to any purchaser of any trust deeds sold by defendant Los Angeles Trust Deed & Mortgage Exchange. There *is* evidence of dissatisfaction by several of such purchasers; and of misrepresentation both by brochure[5] (based on interpretation of the language used) and by salesmen.[6] Thus, of more than two thousand "accounts," there is in this record, evidence that only a small percentage of the Los Angeles Trust Deed & Mortgage Exchange account holders were dissatisfied with what they had received, up to the date of trial.

---

[5]Plaintiff's Exhibit 4, p. 5: "Upon receipt your money is deposited in a *separate trust account* for customer's money." [Emphasis added.]

[6]Affidavit of Weber (R. 108 in support of Motion for Preliminary Injunction and Appointment of Receiver); Affidavit of Lehnhof (R. 150 in support of Motion for Preliminary injunction and Appointment of Receiver). The remaining affidavits disclose use of mails and interstate sales, but no complaints.

There is evidence that the language "You may change, alter or cancel your instructions,"[7] as used in a brochure does *not* mean to defendants that one can obtain a *refund* of moneys if not satisfied, although some purchasers did obtain refunds.[8] Whether such criticized language constitutes a representation that a *refund* will be made is open to serious doubt.

Of course, evidence that every present purchaser of second trust deeds is presently pleased with his purchases would not prove that the plan or system of purchasing and selling second deeds of trust, as pursued by defendant Los Angeles Trust Deed & Mortgage Exchange, is either economically or financially sound or prudent, or that ultimate collapse, with resultant financial loss to thousands of purchasers will not or would not occur.

On oral argument counsel for the SEC agreed that this plan presently being pursued by defendant Los Angeles Trust Deed & Mortgage Exchange would not *necessarily* be unsuccessful. It would come to grief only if the present economic climate of this area, and this period, changed so as to produce (a) large scale foreclosures on residential properties, or (b) a large scale drop in values of improved real estate, or (c) such a scarcity and dearth of "good" second deeds of trust that they could not be purchased at a substantial discount, *i.e.*, their price would rise to par, or a figure close thereto. In the event of any such contingency, a ten percent return could not be obtained.

---

[7]Plaintiff's Ex. 1, p. 10.

[8]Affidavit of Noland (R. 172 in support of Motion for Preliminary Injunction and Appointment of Receiver).

Thus from the evidence thus far introduced, it seems to be entirely *possible*, though perhaps not economically *probable*, that all purchasers of these second deeds of trust may realize their ten percent return, over the life of the trust deeds, provided there exists honest investment and handling of funds. Any conclusion reached depends on looking into the future.

But it is urged upon us that insolvency or bankruptcy of a defendant need not necessarily be proved to justify the appointment of a receiver, but that it should be done when defendants are engaging in "a fraudulent course of business."

The appellee's brief states "the generally fraudulent conduct of appellants' business is clear from the facts." We do not agree. There can be misrepresentations, and perhaps such misrepresentations must be stopped, and perhaps it is the function of the SEC to stop the making of such misrepresentations. It is claimed some have already been stopped by the defendants. But such misrepresentations do not necessarily or clearly equate with a generally fraudulent conduct of appellants' business.

Appellee's brief further states that the court below found (a) that the appellants' advertising material led investors to rely upon fourteen distinct representations that "singly and cumulatively" were "untrue, deceptive and misleading" and (b) that appellants avoided disclosure of at least "nine material facts." The court below did so find.

We recognize that the findings of the trial judge who heard the witnesses are entitled to great weight. Rule 52(a), Fed. R. Civ. P. We give them that weight.

But we are still required to determine if such findings are supported by the evidence. Let us examine such findings and the evidence supporting them.

The first brochure put out by defendant Los Angeles Trust Deed & Mortgage Exchange contained, among other statements, the language hereinabove mentioned in footnote 5, referring to the deposit of customers' money "in a separate trust account." Does that mean an account designated as a "trust account," or one designated as a "customer's account"? Is the latter method (dependent upon how it is used) the legal equivalent of a trust account?

Such language relating to deposit in a trust account was removed from the second brochure used by certain defendants. We believe it should have been, and that it should never have been used in the first brochure. Appellee states "subsequent literature in the main contained equally serious misrepresentations." What such equally serious misrepresentations are has not been pointed out to us.

Appellee criticizes the appellants' literature stressing the *safety* of the investment. Safety of an investment is a relative matter, subject to many differences of opinion. So is the precise definition of a "ready market;" of what constitutes "liquidity;" of what constitutes a "seasoned" note.

Appellee presented evidence to show the liquidity of the Los Angeles Trust Deed & Mortgage Exchange may be below that determined to be a minimum in accordance with the "net capital" rule established under the authority of § 15(c)(3) of the Securities Exchange Act of 1934, 15 U.S.C. § 78o(c)(3). Rule 17 C.F.R.

240.15c.3-1, generally requires brokers and dealers in securities to maintain a twenty to one ratio of aggregate indebtedness to net capital, "or stated in other terms, requires that the assets of a broker or dealer after certain deductions to insure liquidity, exceed his liabilities by an amount equal to 5% of his aggregate indebtedness." A capital deficiency of the defendant Los Angeles Trust Deed & Mortgage Exchange, as set forth in Exhibits 11, 12, 13 and 14, appears to the SEC to exist, but only after certain arbitrary allocations hereinabove discussed are deducted.

We do not here pass upon the applicability of Rule 17 C.F.R. 240.15c3-1 because we have not here considered and do not pass upon the SEC's authority, or whether that which was here sold is a security, or whether Los Angeles Trust Deed & Mortgage Exchange is a dealer in securities.

We cannot agree that the record supports many of the court's findings:

(1) The record fails to support any finding whatsoever against the Trust Deed & Mortgage Market, a corporation.

(2) The record fails to support any finding of insolvency or bankruptcy of Los Angeles Trust Deed & Mortgage Exchange or Trust Deed & Mortgage Exchange.

(3) The record fails to support any finding that there were specific representations that defendant Los Angeles Trust Deed & Mortgage Exchange would repurchase trust deeds if found unsatisfactory.

(4) The record fails to support any finding of a *direct* guarantee against loss of principal and no such

loss was found by the court. A fair reading of the evidence shows that any *implied* guarantee against loss of principal depends on an interpretation of certain facts, and is contradicted by other representations, implied and direct.

The representations made by defendant Los Angeles Trust Deed & Mortgage Exchange [Findings, pp. 7-11, (a) to (n), inclusive] were found to be "singly and cumulatively untrue, deceptive and misleading."

This means that *each* of such statements is found to be untrue, deceptive and misleading. Some of them simply are not false, such as paragraphs denominated in the complaint (a), (c), (d) and (m). As an example, on oral argument, counsel for the SEC did not dispute the mathematical computations contained in (c) or (d). Whether they are deceptive or misleading is extremely doubtful.

Several statements constitute what is ordinarily considered in law mere "puffing." For example, (b). ". . . highest return obtainable with full protection and security." For other examples, (e); parts of (f); parts of (i); and (l).

On the other side of the ledger there are some clear misrepresentations which have been made, at one time or another, by defendant Los Angeles Trust Deed & Mortgage Exchange. In this category we would place: (g) that "the only legal difference between a first or second deed of trust is the fact that one was recorded prior to the other"; (h) that "the 'Program' assures investors of continuous '10% earnings from [their] savings'" (this assumes that the words "assures" and "continuous" are properly ascribed to the quoted por-

tions of the representations by the general effect of the representations actually made); (k) that the funds received from investors are "deposited in a separate trust account . . ."; and, (n) that the company's own funds are used to "warehouse" deeds of trust.

Similar comments might be made about the nature and extent of the "disclosures avoided" by defendant Los Angeles Trust Deed & Mortgage Exchange.

Thus a finding that *some* of the representations are untrue, deceptive and misleading is justified and supported by the evidence. But does this "conclusively establish the allegations of fraud and deceit" alleged in the amended complaint as the trial court found? And on what items did the trial court rely?

Again we repeat that this record fails to disclose that any one person has been "defrauded," in the ordinary legal sense, out of any money. There are no "investors" or "customers" complaining or a party to this law suit. While this is true, we recognize there may well be "fraud and deceit" within the definition of that term, as used in certain statutory enactments regulating securities (15 U.S.C. §77q) and as opposed to the common law definition of fraud and deceit.

The fraud known to common law which required reliance on the alleged false statements and resulting damage to the person addressed is not the fraud required to constitute a violation of § 17(a)(1) of the Securities Act of 1933, 15 U.S.C. § 77q(a)(1). *Bobbroff v. United States,* 9 Cir. 1953, 202 F. 2d 389. *Cf., Llanos v. United States,* 9 Cir. 1953, 206 F. 2d 852, 855. Section 77q(a)(2) creates a violation if there be proved any untrue statement of a material fact or any omission to state a material fact, necessary (in the awkward

words of the statute itself) ". . . in order to make the statements made, in the light of the circumstances under which they were made, not misleading."

Appellee urges that a finding of insolvency is not essential to the appointment of a receiver, relying primarily on *Bailey v. Proctor*, 1 Cir. 1947, 160 F. 2d 78, and *SEC v. Fiscal Fund, Inc.*, D.Del. 1943, 48 F.Supp. 712, 715.

If we are to differentiate between the fraud of common law on the one hand, and on the other the course of business which operates as a fraud or deceit upon the purchaser of securities, or the sale by means of making an untrue statement of any material fact, or the omission of any material fact (*Bobbroff v. United States, supra*), it is not unreasonable for us to presume there was intended by the Congress, and that there is, a distinction between the "fraud and deceit" of § 17(a) of the Securities Act of 1933, and the "gross misconduct" and "gross abuse of trust" of an officer or director of, or the principal underwriter for, a registered investment company. Investment Company Act of 1940, 54 Stat. 841, 15 U.S.C. §80(a)-35.

With this in mind, we examine the facts of the cases cited by appellee. *Bailey v. Proctor, supra*, grew out of *Aldred Inv. Trust v. SEC*, 1 Cir. 1945, 151 F.2d 254, *cert. denied*, 1946, 326 U.S. 795, where the investment policy of the investment trust was changed by a majority common stockholder (the trust having no equity value in its common stock) from concentration in investments in public utilities into concentration in "investments" in the horse racing industry, for the principal purpose of allowing the stockholder to obtain control of

a race track. We do not consider the facts of *Bailey v. Proctor, supra*, comparable to the instant case, nor do we find it controlling. See also, *SEC v. Insurance Sec., Inc.*, 9 Cir. 1958, 254 F.2d 642.

Likewise, *SEC v. Fiscal Fund, Inc., supra*, arose under different provisions (§22(e)) of the Investment Company Act of 1940, 15 U.S.C. § 80a-22(e). There a management investment company had failed and refused, over a considerable period of time, to redeem its shares upon proper demand made by beneficial share holders upon the custodian (Security Trust Co. of Delaware), and its notification of such option having been exercised, to the company.

The company could not act because it had but one officer, and one director, and he was out of the country with the armed forces. Two signatures of officers were required to sell the underlying assets so that the custodian's request to the company could be complied with in accordance with the Fund's legal obligations. Under these circumstances a receiver was appointed.

Again we cannot consider the facts in *SEC v. Fiscal Fund, Inc. supra*, comparable in any real degree to the facts of the instant case, nor do we find it here controlling or persuasive.

We do not dispute the fact that it is within the well established power of the federal court, sitting as a court of equity, to order liquidation of a solvent corporation where there is no other course available to remedy a situation that needs solution. *Riehle v. Margolies*, 1929, 279 U. S. 218. And see Hornstein, A Remedy for Corporate Abuse, 40 *Colum. L. Rev.* 220, 224 (1940). We do not find such a situation here.

Up to this point, we have not considered whether that which was here sold by defendant Los Angeles Trust Deed & Mortgage Exchange was, in the language of the amended complaint, either (a) an evidence of indebtedness, (b) an investment contract, (c) a receipt for or guarantee of such securities issued by the defendant, or whether (d) what was sold was, in the language of the amended complaint, in accordance with an investment plan and program, involving various collateral agreements and undertakings by the defendants. Nor do we propose to do so here.

We do not necessarily reach such points on this appeal which is solely from the order granting a preliminary injunction and appointing a receiver.

We feel we must point out, however, that irrespective of what a purchase price note secured by a second trust deed may be under California law (*Brown v. Jensen*, 1953, 41 Cal. 2d 193, 259 P.2d 425), the view taken by the Supreme Court in *SEC v. C. M. Joiner Leasing Corp.*, 1943, 320 U.S. 344, as to "the dominating general purpose" of Sec. 2(1) of the Act (15 U.S.C. § 77(b) 1), and its "generally expressed legislative policy," indicates that

> ". . . novel, uncommon or irregular devices . . . are reached if it be proved as matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts,' or as 'any interest or instrument commonly known as a security.'"

320 U.S. at 351.

And in disregarding the Texas law defining what was sold, the same Court said:

> "In applying acts of this general purpose, the courts have not been guided by the nature of the assets back of a particular document or offering. The test rather is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect. In the enforcement of an act such as this it is not inappropriate that promoters' offerings be judged as being what they were represented to be."[9]

We suggest that a proper determination of this case requires a factual finding, in the court below, as to whether there was an investment "in a common enterprise," and whether the purchaser "is led to expect profits solely from the efforts of the promoter or a third party." *SEC v. W. J. Howey Co.*, 1946, 328 U.S. 293, 298-99. There must also be a consideration of the various other elements which cause or bar the recognition of a document, plan, course of dealing, or program, as a security—all factors leading to an ultimate conclusion as to whether or not that which is here sold is subject to the Act.

In addition to the matters hereinabove discussed, and entirely apart from them, we find certain procedural matters raised on this appeal that require a reversal of the order entered below.

The deposition of one Charles W. Cannon was taken by plaintiff before trial by stipulation with defendants' counsel. At the deposition, it was "stipulated that all objections, both as to questions or answers, may be reserved until time of trial if the deposition is to be

---

[9] *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. at 352-53.

used at that time." This stipulation was unlike the usual stipulation, which is that all objections, "save as to the form of the question" may be reserved until time of trial. This stipulation was broader, reserving *all* objections.

During the hearing, and on October 24, 1958, there was no formal offer in evidence of the Cannon deposition, nor any motion made for that purpose. Casually, it was suggested by plaintiff's counsel, "that the deposition of Charles W. Cannon . . . shall be considered in evidence on behalf of the Commission." The court answered: "Very well. It may be."

Objection was then made on behalf of the defendants. Their counsel called the trial court's attention to the stipulation under which the deposition was taken, and

> ". . . the many things in the deposition which are objectionable. The witness was led . . . to all sorts of surmises and guesses and conclusions, to which we have a right to object. So until these objections are ruled upon, that deposition of Mr. Cannon, subject to that stipulation, should not be received in evidence, until we have had a chance to object to them.
>
> THE COURT: Well, I will overrule the objection and let it be received."

The depositions of both Cannon and Farrell were thus received in evidence, although for some reason they were not marked in evidence as such, nor given exhibit numbers. The minutes of the court of October 24, 1958, show only the following:

"'On motion of Attorney Kennamer[10] it is ordered that depositions of David Farrell and C. W. Cannon may be admitted into evidence. (No number given.)"

The witness Cannon had been a former employee of the defendant Los Angeles Trust Deed & Mortgage Exchange. He had never read the brochure (Ex. 4), but was called upon to explain terms in it. Many, if not most of the questions asked him by SEC counsel were leading and suggestive of the answers desired. He related what "may have been". After disclaiming knowledge of a certain subject, he was asked leading questions concerning that subject matter. He was asked as to his legal conclusions. When he sought to limit his replies to his own knowledge, he was urged by leading questions to go further. He was even asked about his "feeling" as to what defendants might or might not be able to do in the future!

The foregoing is sufficient to indicate that the defendants were entitled to make their objections to many of the questions asked on this deposition: and to have the court rule on such objections in an intelligent and orderly manner. This right was taken from defendants by the court's ruling.

We do not know whether the trial court read this deposition. We assume that he did. It contained evidence to which legal objections could have been made and sustained. Much of such evidence went to the

[10]Counsel for the SEC.

heart of plaintiff's case,[11] and defendants' defense, and we cannot view the court's ruling as unprejudicial error. It was error, and standing by itself requires a new hearing of this matter.

The motion for a preliminary injunction and appointment of a receiver, heretofore granted by the orders of the trial court dated November 7th, 1958, and November 12th, 1958 (entered November 12, 1958 *nunc pro tunc* as of November 7th, 1958)[12] is, and each in each and every particular are, set aside, and the matter is remanded to the district court for trial in the ordinary course on the issues presented by the Amended and Supplemental Complaint and the answer thereto.

It is probable that both the SEC and the defendants will desire that this matter be heard on its merits at the earliest possible moment. We have no doubt that an early preferential setting for trial can be had.

The Restraining Order heretofore ordered by this Court on November 17th, 1958, against defendants and appellants and each of them, and their officers, agents, servants and employees, prohibiting them and each of them from making any withdrawal of funds from the assets and/or trust funds of the corporate defendants and appellants, other than in the regular and ordinary course of business, is continued in full force and effect until further order of this Court.

(Endorsed:) Opinion. Filed Feb. 17, 1959.

Paul P. O'Brien, Clerk.

---

[11]Cannon's deposition is specifically mentioned by appellee as a document upon which it relies in seeking an injunction and a receiver (Motion, p. 3, para. III), and portions of it are thought to be important enough to be quoted verbatim in the SEC brief on this appeal, or cited in the brief, on twelve or more occasions.

[12]We do not here pass upon the question of the legality of such a *nunc pro tunc* order.

APPENDIX II.

Court of Appeals Order of October 16, 1959.

In the United States Court of Appeals for the Ninth Circuit.

Los Angeles Trust Deed & Mortgage Exchange, et al, Petitioners, vs. Thurmond Clarke, District Judge, Respondent. Misc. No. 888.

Before: Stephens and Barnes, Circuit Judges

Petitioners' motion to stay proceedings in the District Court pending appeal is denied without prejudice to the renewal of such a motion upon a proper showing after the entry below of a decision falling within the provisions of 28 U. S. C. Sections 1291 and 1292, and

The Petition for a Writ of Prohibition and for Mandamus is denied; there being at this time no sufficient or adequate showing of personal bias or prejudice on the part of the judge trying the action in the District Court, and

The purported appeal from the District Court's order dated October 5, 1959, is by this court, sua sponte, dismissed, it being from a non-appealable interlocutory order and not a final decision. 28 U.S.C. Sections 1291 and 1292.

This court assumes that no precipitate action will take place in the court below that will prevent the losing party from applying for a stay of any execution or proceedings supplementary to any final decision herein,

including the designation or appointment of any receiver, if any there should be.

Furthermore it would appear from the oral statements of counsel before us at the hearing that there is a strong misunderstanding between court and counsel as to the existence or non-existence of a proper court order for discovery, which calm reflection and discussion in open court would, in all probability, dispell.

Albert Lee Stephens
Stanley N. Barnes
Circuit Judges

Filed October 16, 1959.

APPENDIX III.

District Court Final Judgment of Permanent Injunction and Order Appointing Receiver, Dated May 20, 1960.

In the United States District Court for the Southern District of California Central Division.

Securities and Exchange Commission, Plaintiff, v. Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Markets, David Farrell, Oliver J. Farrell, Roy A. Bonner, Thomas Wolfe, Jr. and Stanley C. Marks, Defendants. Civil Action No. 261-58 TC.

This action came on for hearing before the Court between October 6, 1959, and May 3, 1960, and the Court having considered all the evidence introduced in the course of the trial on the merits, and the arguments of counsel, and the Court having now entered Findings of Fact and Conclusions of Law to the effect that the evidence sustains the allegations of each Count of the Amended and Supplemental Complaint for Injunction and for Appointment of Receiver, and the Court having found that the Securities and Exchange Commission is entitled to a permanent injunction restraining and enjoining the defendants Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Markets, David Farrell, Oliver J. Farrell, Roy A. Bonner, Thomas Wolfe, Jr. and Stanley C. Marks from engaging in acts or practices which constitute or will constitute vio-

lations of Section 5(a) and (c) of the Securities Act of 1933, 15 U.S.C. §77e(a) and (c), Section 17(a) of the Securities Act of 1933, 15 U.S.C. §77q(a), Section 15(c)(1) of the Securities Exchange Act of 1934, 15 U.S.C. §78o(c)(1), and Rule 17 CFR 240.15c1-2 thereunder, and Section 15(a) of the Securities Exchange Act of 1934, 15 U.S.C. §78o(a), as demanded by the Securities and Exchange Commission, and that a receiver should be appointed for the defendants Los Angeles Trust Deed & Mortgage Exchange and Trust Deed & Mortgage Markets, and it appearing that the Court has jurisdiction of the parties hereto and the subject matter hereof—

I.

IT IS ORDERED, ADJUDGED AND DECREED that the defendants Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Markets, David Farrell, Oliver J. Farrell, Roy A. Bonner, Thomas Wolfe, Jr. and Stanley C. Marks, their officers, agents, servants, employees, attorneys, assigns, and each of them, and all persons acting in concert or participation with them, be and they hereby are permanently restrained and enjoined from, directly or indirectly—

A) making use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell securities, namely, evidences of indebtedness, investment contracts or receipts for or guarantees of such securities, issued by the defendants Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange or Trust Deed & Mortgage Markets, or any other securities, including trust deed or

mortgage notes or other evidences of indebtedness created, issued or acquired by said defendants in connection with any investment plan, program or arrangement heretofore designated by the defendants as a Secured 10% Earnings Program, Secured 10% Earnings Reinvestment Program or Secured 10% Earnings Accounts, or any similar plan, program or arrangement (hereinafter throughout this decree designated as the Secured 10% Earnings Program), based upon the sale to members of the investing public of discounted trust deeds or mortgages covering residential or other real estate situated within the State of California or elsewhere, through the use or medium of a prospectus or otherwise; or

B) carrying such securities or causing them to be carried through the mails or in interstate commerce, by means or instruments of transportation, for the purpose of sale or for delivery after sale,

unless and until a registration statement as to such securities is in effect with the Securities and Exchange Commission; or

C) making use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell such securities, through the use or medium of a prospectus or otherwise, unless and until a registration statement as to such securities has been filed with the Securities and Exchange Commission, or while a registration statement as to such securities is the subject of a refusal order or stop order issued by the Securities and Exchange Commission, or (prior to the effective date of such registration state-

ment) any public proceeding or examination under Section 8 of the Securities Act of 1933, 15 U.S.C. §77h.

II.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the defendants Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Markets, David Farrell, Oliver J. Farrell, Roy A. Bonner, Thomas Wolfe, Jr. and Stanley C. Marks, their officers, agents, servants, employees, attorneys, assigns, and each of them, and all persons acting in concert or participation with them, be and they hereby are permanently restrained and enjoined from, directly or indirectly—

A) making use of any means or instruments of transportation or communication in interstate commerce or of the mails, in the offer or sale of the securities described in Section I hereof, to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchasers of such securities, by making through newspaper or other advertisements, radio or television broadcasts, brochures, pamphlets, sales letters or other literature, any incomplete, ambiguous, flamboyant, misleading, dedeptive or untrue statement of material fact (by means of statistical data, charts, graphs, comparisons, or otherwise) meaning or intending to imply that the Secured 10% Earnings' Program—

a) makes it possible for investors "to enjoy the highest return obtainable with full protec-

tion and security offered by Deeds of Trust secured by Real Estate;"

b) affords investors an opportunity "to buy an income for life without reducing [their] principal" through investments in "prime" deeds of trust;

c) allows investors "an income from accumulated savings, earning [them] $100 per month on $12,000, or $50 a month on $6,000, or $25 on $3,000," enabling investors "to build a nest egg for retirement," or "build an estate", with, for example, an investment of $1,000 with $100 added per month for 120 months accumulating to $20,484;

d) assures investors of continuous "10% earnings from [their] savings;"

e) virtually guarantees investors against loss; or making any untrue or misleading statement to the effect that—

f) Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange or Trust Deed & Mortgage Markets are the oldest and largest institutions "in the world" or "in America" offering such an investment plan, with "years of experience" in charting the course of investors "to personal security and more enjoyment from life;"

g) Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange or Trust Deed & Mortgage Markets are "Investment Bankers;"

h). "the only legal difference between a first or second deed of trust is the fact that one was recorded prior to the other;"

i) the "purpose of the 'Exchange' maintained by Los Angeles Trust Deed & Mortgage Exchange, is to provide a clean, ethical market place for or 'exchange' in which the public can buy and sell notes secured by deeds of trust, just as the 'Stock Exchange' does for stocks and bonds," by means of a trading board and facilities similar to those employed by national securities exchanges, or that "just as the stock market has provided a liquid market for shares of stock in American corporations and changed the course of American business so the Trust Deed & Mortgage Exchange was started to provide a liquid market place for notes secured by deeds of trust;"

j) the funds received from investors are "deposited in a separate trust account . . . ;"

k) the books and records of Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange or Trust Deed & Mortgage Markets are "audited monthly by an independent Certified Public Accounting firm which also acts as auditor for savings and loan associations," or any other independent accountant;

l) by continuously reinvesting their "10% Earnings", investors may "build an estate" from $1,000 to $7,328.07 over 20 years, and by adding $100 monthly to their account they should experience a cumulative growth of $75,936.88 over 20 years;

m) no investor has ever sustained a loss or failed to receive a "full 10% earnings;"

n) Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange and Trust Deed & Mortgage Markets at all times use their own funds in order to acquire notes secured by deeds of trust for inventory or "warehouse" to be sold to investors, or that the funds of investors are never used to acquire such securities for "warehouse" or inventory;

or any untrue or misleading statement of material fact concerning—

o) the financial condition, liquidity or solvency of Los Angeles Trust Deed & Mortgage Exchange or Trust Deed & Mortgage Markets;

p) the "liquidation value" or the "estimated liquidation value" of the accounts of investors;

q) the appraised values of the real estate securing trust deed notes;

r) the circumstances under which and the extent to which Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange and Trust Deed & Mortgage Markets are subject to or amenable to supervision by any state or federal regulatory agency;

s) the adequacy of any "reserve for losses" or "contingency reserve" or any similar "reserve" established by said corporate defendants;

t) the terms or conditions of any trust deed or mortgage, including its maturity or "anticipated term", any subordination clause or agree-

ment to which such obligation may be subject, or the nature and amount of any prior or subsequent lien applicable thereto;

u) the quality of trust deeds sold to investors or introduced into their accounts, or the underlying equities of the owners of the real estate covered thereby;

v) the use of funds entrusted to the defendants Los Angeles Trust Deed & Mortgage Exchange or Trust Deed & Mortgage Markets, in financing real estate subdivisions in which David Farrell or any other officer or director of said defendants has a direct or indirect "participation" or other interest;

w) the debit balances in investors' accounts;

or any other untrue or misleading statement of similar meaning, object or purport; or

B) in offering for sale or selling such securities, by the means and in the manner described in Section II A, omitting to state any material fact with reference to such securities necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, concerning—

a) the speculative nature of such investments;

b) the method used in arranging for the monthly reinvestment of investors' funds, or the lack of certainty that monthly collections or additions to investors' accounts can be continuously reinvested in "prime" deeds of trust, in order to establish a captial appreciation meas-

ured by "earnings" of 10% compounded monthly over any substantial length of time;

c) the distinctions and differences between first deeds of trust and second deeds of trust;

d) the distinctions and differences between trading in fungible securities listed and registered on national securities exchanges offering auction markets in such securities, subject to regulation and control by such exchanges and by federal and state regulatory agencies, including the Securities and Exchange Commission, and the "open market trading", on an option basis, in notes secured by deeds of trust conducted by defendants through Los Angeles Trust Deed & Mortgage Exchange, or the entire lack of any correlation between them;

e) the losses sustained by investors;

f) the source of funds used by defendants to inventory or "warehouse" notes secured by deeds of trust;

g) the financial condition or solvency of Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange or Trust Deed & Mortgage Markets;

h) the circumstances under which the Securities and Exchange Commission brought this action in this Court charging all defendants with violations of the registration and anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934, and the defendants Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Ex-

change and Trust Deed & Mortgage Markets with violations of the broker-dealer registration requirements of the Securities Exchange Act of 1934, the status of such proceedings, or the findings or rulings of this or any other Court with reference thereto;

i) the background, integrity or qualifications of the officers or directors of or personnel employed by the defendants Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange or Trust Deed & Mortgage Markets, including the fact that C. W. Cannon, former comptroller of Los Angeles Trust Deed & Mortgage Exchange, has been convicted of grand theft and disbarred from the practice of law, and that David Farrell, controlling stockholder and managing officer of Los Angeles Trust Deed & Mortgage Exchange is a former bankrupt;

or the omission of any other material fact of similar object or purport; or

C) in offering for sale or selling such securities, by the means and in the manner described in Section II, soliciting or accepting funds from members of the investing public, through representations that all such funds are deposited in a special trust account and may be withdrawn only after the defendants have selected a note and deed of trust from inventory or "warehouse" for assignment to each investor and said investor has approved and accepted such selection, and that, pending such acceptance, funds so deposited by

investors may be withdrawn by them at any time and the purchase authorization to defendants cancelled, when in fact, defendants do not so maintain investors' funds in a special trust account, but on the contrary, said defendants commingle such trust funds with the general funds of the defendants Los Angeles Trust Deed & Mortgage Exchange and Trust Deed & Mortgage Markets, and misappropriate and otherwise misuse funds entrusted to said corporate defendants; or in so soliciting or receiving funds or deposits from investors, omitting or otherwise concealing the fact that the defendants Los Angeles Trust Deed & Mortgage Exchange and Trust Deed & Mortgage Markets are insolvent or unable to meet their current liabilities, and the further fact that funds received by defendants from investors are constantly endangered and in jeopardy;

or any other untrue or misleading statement of similar meaning, object or purport; or

III.

in offering for sale or selling the securities described in Section II, by the means and in the manner stated therein, obtaining money or property by means of any untrue statement of material fact or omission to state any material fact specified in Section II.

IV.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the defendants Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange and Trust Deed & Mortgage Mar-

kets, as brokers and dealers, their officers, agents, servants, employees, attorneys, assigns, and each of them, and all persons acting in concert or participation with them, be and they hereby are permanently restrained and enjoined from, directly or indirectly—

making use of the mails or of any means or instrumentalities of interstate commerce to effect transactions in, or to induce the purchase or sale of, securities (other than commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, by means of any manipulative, deceptive, or other fraudulent device or contrivance—

a) by engaging in any of the acts or practices specified in Section II; or

b) by representing by the use of the word "Exchange" in the respective corporate designations of the defendants Los Angeles Trust Deed & Mortgage Exchange or Trust Deed & Mortgage Exchange, or in any other way, that either of such defendants is a securities exchange when such defendant is not a securities exchange.

V.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the defendants Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange and Trust Deed & Mortgage Markets, as brokers or dealers (whose business is not exclusively intrastate), their officers, agents, servants, employees, attorneys, assigns, and each of them, and all persons acting in concert or participation with them,

be and they hereby are permanently restrained and enjoined from, directly or indirectly—

making use of the mails or of any means or instrumentalities of interstate commerce to effect transactions in, or to induce the purchase or sale of, securities (other than exempted securities or commercial paper, bankers' acceptances or commercial bills) otherwise than on a national securities exchange, unless and until such defendants are registered with the Securities and Exchange Commission, in accordance with Section 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78o(b).

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that Pat A. McCormick, of Los Angeles County, California, be and he hereby is appointed receiver of Los Angeles Trust Deed & Mortgage Exchange and Trust Deed & Mortgage Markets, with directions to accomplish the orderly liquidation of Los Angles Trust Deed & Mortgage Exchange and Trust Deed & Mortgage Markets subject to his submission of a good and sufficient bond in the amount of $250,000, conditioned upon the faithful performance of his duties as said receiver, and having taken the oath required by law and being otherwise qualified.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that said receiver shall take immediate custody, control and possession of all of the funds, property, premises and other assets of or in the possession or under the control of the defendants Los Angeles Trust Deed & Mortgage Exchange and Trust

Deed & Mortgage Markets, wheresoever situated, with full power to sue for, collect, receive, and take into possession all goods, chattels, rights, credits, monies, effects, lands, books and records of account, and other papers and documents of said defendants, and of investors whose accounts have been established with such defendants under defendants' Secured 10% Earnings Program or otherwise, which are now held or under the control of said defendants; to conserve, hold and manage all such assets, pending further order of this Court, in order to prevent irreparable loss, damage and injury to investors, to conserve and prevent the further withdrawal and misapplication of funds entrusted to said defendants; to obtain an accounting thereof; to determine, adjust and protect the equities of thousands of investors whose savings have been entrusted to Los Angeles Trust Deed & Mortgage Exchange and Trust Deed & Mortgage Markets; and to prevent further violations by defendants, their officers, agents, servants employees, attorneys and assigns of Section 5(a) and (c) of the Securities Act of 1933, 15 U.S.C. §77e(a) and (c), Section 17(a) of the Securities Act of 1933, 15 U.S.C. §77q(a), Section 15(c)(1) of the Securities Exchange Act of 1934, 15 U.S.C. §78o(c)(1), and Rule 17 CFR 240.15c1-2 thereunder, and Section 15(a) of the Securities Exchange Act of 1934, 15 U.S.C. §78o(a), as specified in Sections I, II, III, IV and V hereof.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that said receiver be and he hereby is authorized to make such payments and disbursements from the funds so taken into his custody, control and possession or thereafter received by him, and to in-

cur such expenses as may be necessary and advisable in discharging his duties as receiver.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the defendants Los Angeles Trust Deed & Mortgage Exchange and Trust Deed & Mortgage Markets, their officers, agents, managers and employees, be and they hereby are commanded and required to deliver over to said receiver possession and custody of all funds, securities, including trust deeds or mortgage notes, property, premises, and other assets, and all books and records of accounts, title documents and other papers of said defendants, and all funds, trust deeds and mortgages, and other assets belonging to investors now held by said defendants under the Secured 10% Earnings Program, or otherwise, and said defendants, their officers, agents, managers and employees, be and they hereby are enjoined and restrained from interfering with said receiver taking such custody, control and possession, and from interfering in any manner, directly or indirectly, with such custody, possession and control by said receiver.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that said receiver be and he hereby is authorized to engage and employ competent accountants and appraisers to audit and investigate the books, records and accounts of said defendants Los Angeles Trust Deed & Mortgage Exchange and Trust Deed & Mortgage Markets, and to evaluate the assets of said defendants and to submit suitable reports of such audit, appraisal and evaluation. The appointment of such accountants and appraisers and the nature of their compensation shall be subject to the approval of the Court.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that said receiver shall have full power to resist and defend all suits, actions, claims and demands which may now be pending or which may be brought or asserted against the defendants Los Angeles Trust Deed & Mortgage Exchange and Trust Deed & Mortgage Markets.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that said receiver, and any counsel whom the receiver may select, subject to the approval of the Court, shall be entitled to compensation from the assets now held by or in the possession or control of, or which may be received by the defendants Los Angeles Trust Deed & Mortgage Exchange and Trust Deed & Mortgage Markets, in an amount or amounts commensurate with their duties and obligations in the circumstances.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the Court reserves the right to make and enter such further orders or decrees, upon application of said receiver or otherwise, that may be necessary for the guidance of said receiver in his administration of the receivership herein established.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the Court reserves jurisdiction to determine whether Trust Deed & Mortgage Exchange shall be included within the receivership established herein, and, pending report to the Court by the receiver appointed for Los Angeles Trust Deed & Mortgage Exchange and Trust Deed & Mortgage Markets, the defendant Trust Deed & Mortgage Exchange, its officers, agents, attorneys and employees, are here-

by ordered and directed to cooperate with and assist said receiver for Los Angeles Trust Deed & Mortgage Exchange and Trust Deed & Mortgage Markets in his administration of the receivership herein established.

APPROVED:

ARTHUR E. PENNEKAMP

Arthur E. Pennekamp
Regional Administrator

F. E. KENNAMER, JR.

F. E. Kennamer, Jr.
Chief Enforcement Attorney

MILFORD A. MARON

Milford A. Maron
Attorney

SECURITIES AND EXCHANGE COMMISSION

May 20, 1960.

THURMOND CLARKE
United States District Judge

APPENDIX IV.

Court of Appeals Order of June 7, 1960.

In the United States Court of Appeals for the Ninth Circuit.

Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Markets, David Farrell, Oliver J. Farrell, Roy A. Bonner, Thomas Wolfe, Jr., and Stanley C. Marks, Appellants, vs. Securities and Exchange Commission, Appellee. *Undocketed.*

Before: Chambers, Barnes and Jertberg, Circuit Judges.

Appellants have filed a notice of appeal from the "Final Judgment of Permanent Injunction and Order Appointing Receiver" in Civil Action Number 261-53-TC, heretofore pending in the United States District Court for the Southern District of California, Central Division. Additionally, appellants gave notice of intention to move this Court, and have moved this Court, for an order staying said judgment and order until the appeal may be heard on its merits. Under date of May 20, 1960, said United States District Court, Southern District of California, Central Division, made its order staying the effective date of said "Final Judgment of Permanent Injunction and Order Appointing Receiver" until June 7, 1960, at 10:00 A.M.

This Court from the bench has granted a stay of said "Final Judgment of Permanent Injunction and

Order Appointing Receiver" (heretofore stayed until June 7th, 1960, at 10:00 A.M.) until appellants' motion for stay pending appeal may be determined.

Appellants have likewise moved to expedite the appeal. Such motion to expedite is granted. Appellants may file an original and three typewritten copies of the record on appeal and may file the required number of printed, multi-lithed, or similarly processed briefs.

Appellants' brief is to be filed by August 5, 1960; Appellee's brief, by August 26, 1960; Appellants' reply brief, by September 2, 1960, and the appeal is set down for hearing on September 16, 1960.

Pending the determination of the appeal from the "Final Judgment of Permanent Injunction and Order Appointing Receiver" issued by said United States District Court, Southern District of California, Central Division, under date of May 20, 1960, the said final judgment and order is modified as follows:

The operation and effect of the following portions are suspended until the further order of this Court:

(a) Paragraph I.

(b) Paragraph II.

(c) Paragraph III (actually part of Paragraph II).

(d) Paragraph IV.

(e) Paragraph V.

(f) The words "with directions to accomplish the orderly liquidation of Los Angeles Trust Deed

& Mortgage Exchange and Trust Deed and Mortgage Markets" as such language appears on page 10, lines 17 and 18.

The purpose of the foregoing modification and suspension of the stay heretofore granted is to permit the Receiver to maintain, preserve and conserve, the assets subject to said Judgment during the pendency of the appeal from said Judgment.

Other than as hereinabove modified, the said "Final Judgment of Permanent Injunction and Order Appointing Receiver" is unmodified, and is not stayed, and is to remain in full force and effect during the pendency of this appeal in every particular.

This Court reserves the right to further modifiy or change this order during the pendency of the appeal.

/s/ Richard H. Chambers
/s/ Stanley N. Barnes
/s/ Gilbert H. Jertberg
United States Circuit Judges

Dated: June 7th, 1960

Note: A true copy:

Attest: Frank H. Schmid, Clerk
Floyd H. Ray, Deputy Clerk

(Seal of the Court.)

APPENDIX V.

Court of Appeals Opinion and Order of July 14, 1960.

United States Court of Appeals for the Ninth Circuit.

Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Markets, David Farrell, Oliver J. Farrell, Roy A. Bonner, Thomas Wolfe, Jr., and Stanley C. Marks, Appellants, vs. Securities and Exchange Commission, Appellee. No. 16,995.

Before: Chambers, Barnes and Jertberg, Circuit Judges.

Per Curiam:

At the behest of the Securities and Exchange Commission, a receiver was appointed on May 20, 1960, by the United States District Court for the Southern District of California. The receivership especially involved the property of the Los Angles Trust Deed & Mortgage Exchange. We do not here attempt a self-sufficient description of the order of May 20, 1960. Reference may be made thereto.

In effect, the command of the district court's order was "liquidate and close them out." The appointment of a receiver by the district court was ancillary to other relief. An appeal has been taken against the entire judgment.

On June 7, 1960, on appellant's motion to grant a full stay, we granted a partial stay. That order con-

templated a conservator receiver pending appeal. Among other things, it said:

> "The purpose of the [foregoing] modification and suspension of the stay heretofore granted is to permit the receiver to maintain, preserve and conserve the assets subject to said judgment during the pendency of the appeal from said judgment."

On June 9, 1960, appellants in a petition sought clarification of our order of June 7, and we then entered an order with an operative part as follows:

> "The cause is remanded to the District Court for hearing in due course of this petition and any other matters requiring interpretation or enforcement prior to the determintion of the appeal, together with all details of administration."

Now the receiver asks for authority to accomplish orderly liquidation and to include the appellant "Trust Deed & Mortgage Exchange" within the force of the receivership and to order a hearing in district court thereon. This petition filed July 6, 1950, is denied. It is without prejudice simply because we do not want to establish the "law of the case" at this time.

Under our order of June 7, 1950, our purpose was just as expressed therein. We think it not inappropriate to say that obviously liquidation and conservation are not mutually exclusive terms. For example, to some extent collection of any debt may be called liquidation.

We think our order of June 7, 1960, does say where the emphasis should be in the receivership, but the scope is otherwise with the district court.

Some confusion has arisen from the fact that the trial was had before Judge "A" who entered the judgment on May 20, 1960. When we entered our orders of June 7 and 9, Judge "A" was out of the country. In need of immediate attention, the case was reassigned to Judge "B" under the rules of the Southern District of California.

The receiver's petition as filed assumed the case is back with Judge "A", but there is no record in the Southern District that so indicates. Judge "B" has matters under submission on the case. And we shall assume that Judge "B" has the case until otherwise advised. The point would be entirely unimportant if the receiver had not proposed a suggestion, now withdrawn, that a referral be made of the current petition to Judge "A". This has evoked a violent reaction from appellants, particularly in a three page affidavit filed here on July 12, 1960. Inasmuch as the case does not appear to be with Judge "A", we shall now take notice of the three page affidavit only to the extent of ordering it sealed up, to be unsealed only on order of this court.

(Endorsed) Per Curiam Opinion Filed July 14, 1960.
Frank H. Schmid, Clerk.

APPENDIX VI.

Court of Appeals Opinion of November 23, 1960.

United States Court of Appeals for the Ninth Circuit.

Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Markets, David Farrell, Oliver J. Farrell, Roy A. Bonner, Thomas Wolfe, Jr. and Stanley C. Marks, Appellants, vs. Securities and Exchange Commission, Appellee. No. 16,995. Nov. 23, 1960.

On Appeal from the United States District Court for the Southern District of California, Central Division.

Before: Chambers, Barnes and Jertberg, Circuit Judges. Barnes, Circuit Judge:

The Securities and Exchange Commission (referred to herein as SEC) instituted suit against three corporate defendants[1] and five individual officers thereof in the United States District Court for the Southern District of California. Originally the defendants were charged with issuing and selling securities in a fraudulent and deceitful manner, using the mails to effect sales of securities by fraud, and violating certain provisions of the Securities Act of 1933 (15 U.S.C § 77q) and the Securities Exchange Act of 1934 (15 U.S.C. § 78o), with respect to the registration of securities. By amended complaint, the defendants were charged with insolvency. While originally seeking merely in-

[1]Los Angeles Trust Deed & Mortgage Exchange (herein sometimes referred to as LATD); Trust Deed & Mortgage Exchange (herein sometimes referred to as TD&ME); and, Trust Deed & Mortgage Markets (herein sometimes referred to as TD&MM).

junctive compliance with the Securities Acts, the SEC subsequently additionally requested the appointment of a receiver, and liquidation of the defendant corporations.

This matter has been before us previously. Under date of November 17, 1958, this court, after a partial trial below, the granting of a preliminary injunction, and the appointment of a receiver, stayed the operation of such orders pending appeal, issued a substitute restraining order, and expedited the appeal. That appeal was heard on January 23, 1959, and on February 17, 1959, an order was made by this court setting aside the preliminary injunction and order appointing receiver made below for the reasons stated in that opinion and the matter was remanded for a complete trial on the merits. Our restraining order of November 17, 1958, prohibiting and restraining defendants from making any withdrawals of funds save in the ordinary course of business, was continued in full force and effect pending the trial. *Cf.* 264 F.2d 199 (1959). For a clearer understanding of the pleadings and issues we refer to that opinion and incorporate it herein by reference. It will not herein be necessary to repeat all the facts.

On May 20, 1960, the court below, after a full trial appointed a receiver for two of the three named corporate defendants. (186 F.Supp. 830.)

By *per curiam* opinion and order dated June 7, 1960, this court, on defendants' motion to grant a full stay of the district court's order, granted a partial stay. We interpreted the order made below as requiring a complete liquidation by the receiver of the defendant corporations. We stayed that order for complete liquidation so that defendants, who had appealed the entire

judgment, would not, if successful on their appeal, gain a Pyrrhic victory. We ordered the receiver "to maintain, preserve, and conserve the assets" pending the determination of this appeal.

Thereafter, on June 9, 1960, when appellants sought clarification of our order of June 7, 1960, we referred them to the district court for "interpretation or enforcement" of that court's orders, "together with all details of administration," pending the determination of the second appeal.

Subsequently, on July 6, 1960, the receiver petitioned us for authority to "accomplish orderly liquidation" and bring the third corporate defendant (Trust Deed & Mortgage Exchange) within the provisions of the district court's orders. This petition was denied (without prejudice), because we did not desire to establish "the law of the case" without a full scale hearing of all issues which were to be raised on appeal. We refer to and incorporate by reference our opinion and order in this regard, filed July 14, 1960 (No. 16995, unreported).

The jurisdiction of the court below rests upon section 22(a) of the Securities Act of 1933 (15 U.S.C. § 77v(a)) as to three counts, and upon section 27 of the Securities Exchange Act of 1934 (15 U.S.C. § 78aa) as to two counts. This reliance by the government on such statutes assumes that the subject of the SEC's attack herein is "a security." This assumption is disputed by appellants, and is the principal issue on this appeal, of which this court has jurisdiction. 28 U.S.C. § 1291.

This case comes before us on a large record. The findings are printed, and allegedly contain 42,000 words.

The judgment, likewise printed, consists of some 5,000 words. The transcript of testimony covers thirty-nine days of trial, and some 3,600 typewritten pages, exclusive of hundreds of exhibits. We cannot attempt to cover the facts in this opinion. Suffice it to say, the appellants insist they are engaged in selling to the public what they maintain are individual trust deeds or mortgages, and what the SEC maintains constitutes an investment plan or contract, designated and commonly known as the "Secured 10% Earnings Program" Apparently some 9,000 investors have committed some forty million dollars to appellants' care.

There are five questions raised in this case:

I. Are appellants selling securities?

II. If they are, are appellants guilty of violation of the securities laws hereinabove mentioned?

III. Did the appellants have a fair trial of the issues, or was the trial judge prejudiced?

IV. Did the court below err in its rulings with respect to the admission of evidence?

V. Did the court below have jurisdiction (a) to appoint a receiver, and (b) to order liquidation?

We discuss each issue in turn.

I. *Was that which was sold a security within the Act?* (15 U.S.C. § 77b(1); § 2(1) of the Act.)

The SEC contends that the sale here, through the "Secured 10% Earnings Program" constitued more than a simple sale of second trust deeds—and interest in real property; that what was really offered here was an investment contract. Under section 2 of the Securities

Act, an "investment contract" is specifically mentioned as a "security" subject to the regulatory provisions of the Act.

Two Supreme Court cases must guide us in solving this problem. In *S.E.C. v. Joiner Corp.*, 1943, 320 U.S. 344, both the district court and the court of appeals had previously construed § 5(a) and § 17(a)(2) and (3) of the Securities Act so as to exclude from its operation trading in oil and gas leases. Investors purchased assignments of oil leases on small parcels of land; the underlying leases containing an agreement that lessees would drill a test well located somewhere in the large tract. Defendant Joiner agreed to drill the well and financed its cost by the sale of these small leasehold assignments to "investors" or "purchasers." The following facts were deemed significant by the Supreme Court:

(1) Sales literature nowhere mentioned the drilling conditions a purchaser would meet, or costs the purchaser would incur, if he attempted to drill his own acreage.

(2) Joiner promised to complete the test well, which would constitute a test applicable to all leaseholds sold in common.

(3) The advertising literature emphasized the character of the purchase as an investment, and as a participation in an enterprise.

(4) The leasehold interests were described as "securities . . . believed exempted from registration with the S.E.C."

The Supreme Court disagreed with both lower courts and held that the "defendants were not, as a practical

matter, offering naked leasehold rights." The "economic inducement" that Joiner would drill a well, "runs through the whole transaction as the thread on which everybody's beads were strung." *Id.* at 348. This was "a form of investment contract in which the purchaser was paying both for a lease and for a development project." *Id.* at 349.

Instruments may be included within the term "securities" as defined in the Act, "if on their face they answer to the name or description,"[2] but:

> "[T]he reach of the Act does not stop with the obvious and commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contractors' or as 'any interest or instrument commonly knows a "security".'
>
> * * * * *
>
> "The test is what character the instrument is given in commerce by the terms of the offer, the

[2]Section 2(1) of the Act, 15 U.S.C. § 77b(1), provides.

"The term 'security' means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable shares, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a 'security', or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."

plan of distribution, and the economic inducements held out to the prospect. In the enforcement of an act such as this, it is not inapprorpriate that promoters' offerings be judged as being what they were represented to be." *Id.* at 351, 352-3.

The Supreme Court thereupon granted the SEC an injunction restraining respondents from further violations of certain sections of the Act.

The second Supreme Court case is *S. E. C. v. Howey Co.*, 1946, 328 U. S. 293. Investors there also had purchased an interest in real property—a unit of acreage in a citrus grove owned by one defendant. Investors were encouraged to, and most, but not all, of them did enter into a service agreement with a second companion corporation, whereby it was agreed that the management and control of the citrus acreage was in the service company's hands exclusively—"full and complete possession." The annual return to each investor was an allocation of percentage profits based on the sale of all of the product of the entire orange grove.

Again the district court refused to grant the injunction requested by the SEC, and the court of appeals (Fifth Circuit) affirmed the refusal. This, because both courts looked upon the transaction as two severable contractual relationships—one with Howey Co. to buy land only, and one with "Howey In The Hill's Service, Inc." to supervise and service the growing crops and no more.

The Supreme Court reversed, holding the transactions in the Howey case "clearly" involve investment contracts as defined in the Act. "All the elements of a

profit-seeking business venture are present here. . . The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." *Id.* at 300, 301.

We are likewise referred to the following cases: *cf.* also: *Penfield Co. v. S. E. C.*, 9 Cir., 1944, 143 F. 2d 746; *Atherton v. United States*, 9 Cir., 1942, 128 F. 2d 463; *S. E. C. v. Univ. Service Ass'n*, 7 Cir., 1939, 106 F. 2d 232, *S. E. C. v. Crude Oil Corp.*, 7 Cir., 1937, 93 F. 2d 844 (barrels of oil); *S. E. C. v. Bourbon Sales Corp.*, W. D. Ky., 1942, 47 F. Supp. 70; *S. E. C. v. Bailey*, S. D. Fla., 1941, 41 F. Supp. 647 (land bearing tung trees); *S. E. C. v. Payne*, S. D. N. Y., 1940, 35 F. Supp. 873 (silver foxes); *S. E. C. v. Pyne, Mass.*, 1940, 33 F. Supp. 988; *S. E. C. v. Tung Corp.*, N. D. Ill., 1940, 32 F. Supp. 371 (land bearing tung trees); *S. E. C. v. Timetrust, Inc.*, N. D. Cal., 1939, 28 F. Supp. 34; *S. E. C. v. Wickham*, Minn., 1935, 12 F. Supp. 245; *Probaska v. Hemmer, et al.*, 1930, 256 Ill. App. 331 (land payable from crops raised by vendor); *Holloway v. Thompson*, 1942, 112 Ind. App. 229, 42 N. E. 2d 421 (cemetery lots); *Kerst v. Nelson*, 1927, 171 Minn. 191, 213 N. W. 904 (land); *Matter of Waldstein*, 1936, 291 N. Y. S. 697, 160 Misc. 763 (cemetery lots).

Thus *Howey* adds the test of *common enterprise* to the *Joiner* test of *results dependent on the efforts of one other than the purchaser.*

Appellants argue that the test of *Howey*, as it modifies *Joiner*, is not discovered in the facts of this case: that the choice of the trust deeds *was* solely within the discretion and judgment of the purchaser; that each

purchaser had an absolute right of rejection for any reason whatever within five days after designation by the appellants; that the supervision and other extra services offered are only in the nature of an accommodation, and are not an inherent or essential part of the thing that is sold—namely, "a trust deed on specific real estate."

We ask ourselves the question: Is the investor led to expect profits solely from the efforts of one or more defendants arising from a common enterprise?

Howey, supra, teaches us that the statutory policy in the mind of the Congress in passing SEC regulations to afford "broad protection to investors is not to be thwarted by unrealistic and irrelevant formulae." *Id.* at 301. And we are admonished to judge "the promoters' offerings . . . as being what they were represented to be." *S. E. C. v. Joiner, supra* at 353.

With these instructions in mind, we have examined the evidence. Very few persons, particularly those unskilled in financial matters, could read the advertising of the appellants without coming to the firm conclusion that by sending moneys to the appellants they would receive far more than a note secured by a second mortgage or deed of trust on specific real estate.

(a) In the first place, many of the purchasers never saw the deed of trust they purchased, or the real property by which it was secured. In many, but not all cases no physical delivery was made. Purchasers were

assured that it was the company's policy to repurchase any delinquent trust deed, so that the purchaser would suffer no loss if he had by chance purchased one that later defaulted. A reserve to protect the Los Angeles Trust Deed & Mortgage Exchange from any loss by reason of such a repurchase was set up by appellants.

(b) The purchaser was encouraged to rely on the skill and knowledge of the appellants' officers, who were reported to check and recheck the worth of the trust deeds. Customers paid into "accounts." They were encouraged to instruct the Los Angeles Trust Deed & Mortgage Exchange to "collect and service the notes purchased . . . to record title in the name of the Los Angeles Trust Deed & Mortgage Exchange as Trustee . . ."; to authorize LATD "to place notes in our portfolio"; to apply all principal and interests received to paying off additional purchases. In all this there was reliance on the appellants; an anticipated common effort.

(c) Plaintiff's Exhibit 30-A and Defendants' Exhibit D were copies of the booklet or brochure published in December 1957, which induced many of appellants' customers to pay money into "accounts." A casual reading of such booklet discloses that investors were assured of many things beyond the representations usually made to investors in securities. Some of these appear in the margin.[3] Other, and earlier

[3]It was represented by appellants to the public: (a) that "your money [will be] earning a current 10%. *We have carefully devised a controlled program* to provide you with a current 10% return on your funds *and at the same time keep them individually secured.*" (b) "We emphasize that every attempt is made to see that your current 10% earnings are maintained through continual reinvestment." (c) "The very best notes are carefully

pamphlets or brochures, disclose many of the same representations. It is true changes were made in such representations. Instead of the phrase *"Our* 10% Earnings *Program,"* used in 1958, the phrase originally used was *"Your* Secured 10% Earnings *Account."* (Emphasis added.) "How to begin your program" in December 1957, became "How to open your account" in the July 1958 brochure, which became "How to start earning a secured 10%" in July 1959.

In a simple "throw away" printed in 1957, the following appears:

(1) "Your money (even small amounts) keeps working for you all the time."

---

processed to determine the value of the property, 'whether the owner has a large cash equity;' if his credit and job are stable; whether the note is valid," etc. "All these points are checked and rechecked by experts in their particular fields with many years of experience." (d) "A note is then 'warehoused' until it either seasons or fits properly into the portfolio of a particular investor. It is then again checked carefully." (e) "Your money is protected through our bonded status." (f) "Upon receipt your money is deposited *in a separate trust account for customer money."* (g) "You receive a certificate of registration *and guarantee* . . ." (h) "You can plan now your projected *investment program."* (i) "Should you desire to terminate *your program,* your funds plus *accrued* interest are immediately available upon liquidation of the notes in your account . . . We have never failed to honor a request for liquidation . . . Our policy is to do our best to protect the investor with every resource and intelligent principle at our command." (j) "We make no charge for reselling and there are no penalties or hidden charges *or loss of interest* in connection with termination of this *program."* (k) ["Foreclosure] is a simple procedure, and of course, we would handle the details without additional cost." (l) "We notify you of such a default and *give you an opportunity to foreclose the property yourself and make the extra profit* if you so desire" (m) "The 'yield' on notes selected for *your account* is a *full, firm* return." (n). "Full coverage having resulted from investor telling investor of our many services . . . our firm has had the time and experience necessary *to develop a completely coordinated system."* (o) "The only legal difference between a first or second trust deed is the fact that one was recorded prior to the other." (All emphasis added.)

(2) "Your investment *earns* a 10% income."

(3) "Collection of your income and servicing of your account are all handled by us."

(4) "Our selections are made to fit your program, your needs."

In considering such representations made by the LATD after 1957, we note only in passing the earlier pamphlets and brochures, where the appellant firms are characterized as "investment bankers . . . specializing in Real Estate Securities," and the advertising referring to "investment securities." Such representations, we understand, were not made in later brochures and pamphlets.

(d) In addition to the foregoing, there appear instances in the record where trust deeds "sold" to investors' accounts were "repurchased" by the appellants, in order that one or more appellant corporation could profit from the proposed accelerated payment of principal. These accelerated payments were indicated to the Trustee and known to the appellants, but such knowledge was not communicated to the "purchaser," nor was the "purchaser" given the profit on such payment in full before maturity. Profit was taken by the appellant corporations. Appellants urge that this was done by mistake—admitting by such defense that appellants' actions in some instances, at least, fly in the face of any attempt to characterize appellants' sales as individual and ordinary sales of specific trust deeds. Appellants also urge that the taking of such "windfall" profits occurred so seldom it is unfair to include such incidents within the pattern of appellants' actions. We cannot

agree.[4] We do not know what percentage of the total trust deeds sold by appellants were paid off prior to maturity, and of them, how many were repurchased by appellants. We are satisfied, however, that they were

---

[4]See Finding XI, B (2), p. 35, "Printed Findings of Fact and Conclusions of Law Dated May 20, 1960."
Finding XI, "Evidence of Fraud," B 1 through B. 12, reads as follows.

"B. *Manipulation of Investors' Accounts to Realize 'Windfall' Profits.*

"1. Although LATD represents to investors that they may 'earn' more than 10% on trust deed notes held in their portfolios in the event the trustors liquidate their obligations in advance of maturity, thereby establishing 'windfall' profits to the investors, it has been the consistent practice of LATD, in such situations, to withdraw such trust deeds from investors accounts and secretly appropriate the profits to itself. The following is a classic example of such gross overreaching of investors.

"2. On April 1, 1959, LATD purchased 43 notes secured by second deeds of trust on Tract 3068, known as Riviera I and Riviera II. The homes were constructed on leasehold estates. Each note had a face value of $3,500. LATD purchased the notes for $2,345 each and sold them to its investors for an average of approximately $3,213 each, realizing a profit on the 43 notes of $37,353. Under date of September 29, 1959, LATD received notice that an escrow had been established with Newport Balboa Savings & Loan Association under which the 43 notes were to be satisfied in full, in advance of maturity, and a request that LATD forward the original notes, deeds of trust, signed requests for reconveyance and its demands for reconveyance. The notice also stated that, 'They will of course be used only when we hold for your account the full amount of your demand.'

"3. In October, 1959, LATD sent form letters to the investors in the 43 trust deed notes advising them, in part, '. . . We find it desirable to repurchase this Deed of Trust at this time in accordance with our regular procedure whenever further action is required. The price to repurchase the Deed of Trust will be credited to your purchase authorization.'

"4. By letters dated October 19 and 20, 1959, LATD transmitted to Newport Balboa Savings & Loan Association 28 of the 43 notes and deeds of trust, specifying that the Association could deliver them to the parties in interest when it held for LATD the sum of $3,426 each (face

a substantial, if not a large, number and sufficient instances were proved from which there could be established by inference a designed pattern of conduct.

(e) Repeated representations were made to prospective "purchasers" by both brochure and newspaper ad-

---

value), with interest at the rate of 7% per annum until the date received.

"5. LATD, during October, 1959, removed the 43 deeds of trust from the investors' accounts, crediting each account $3,190, although LATD anticipated receiving $3,426 for each such deed of trust on reconveyance or an additional and secret profit of $9,897. The investors were not advised that LATD was to receive the full balance due on the notes, nor were they given the opportunity of determining whether they themselves should reconvey and realize the additional profit.

"6. The entire sequence of events in which LATD sought to appropriate the 'windfall' profits belonging to investors, in callous disregard of their legal and moral obligations to such investors, is elaborately set forth in a schedule (PX 77), the accuracy of which is admitted by the defendants. In this instance, the fact that LATD had retained title to 20 of the 43 trust deeds as 'Trustee' for the investors facilitated its unilateral removal of the trust deeds from the accounts of those investors. In such instances, LATD merely advised the investors that the trust deeds were being removed from their accounts.

"7. In another and unrelated situation, on March 20, 1959, LATD purchased trust deed No. 7195M for $3,274, and on May 1, 1959 sold it to Benjamin C. Griswold for $4,112. About August 4, 1959, LATD received a letter from Bank of America advising that the trustor had opened an escrow in order to liquidate his obligation in advance of maturity, and requesting that LATD forward the necessary papers, together with its demand for their use.

"8. On August 20, 1959, LATD forwarded the necessary instruments to Bank of America and advised that the unpaid principal balance of the note was $4,377 with interest paid to June 1, 1959. On September 8, 1959, Bank of America mailed to LATD a check in the amount of $4,459, representing the entire balance due on the note. On September 9, 1959, LATD advised the investor as follows:

'We find it necessary to withdraw this Deed of Trust at this time.

This is according to our regular procedure whenever further action is required.'

vertisements that "accounts opened by the 20th . . . or additions received by the 20th . . . earn from the 1st."

This was accomplished, at least in some instances, where the purchasers' funds had remained uninvested

---

On September 18, 1959, the ledger account of the investor was credited with $4,027. The ledger card contains the notation 'Repurchased TD-7195.'

"9. The investor was not notified by LATD that it had received settlement in full of the balance due on the note. The 'further action' required in this situation was simply the appropriation by LATD of the difference between the $4,459 received from the trustor and the $4,027 credited to the account of the investor, or the sum of $434 which rightfully belonged to the investor.

"10. In still another such situation, in July, 1959, LATD received a letter from the trustor of deed of trust No. 7177, stating, '. . . we are planning to sell and the purchaser is desirous of paying off my note to you . . .' On July 31, 1959, LATD advised the trustor that 'the unpaid principal balance is $1,321.24 with interest paid to July 1, 1959.' On August 19, 1959, LATD addressed a letter to Security First National Bank stating, 'We have been advised that an order has been opened with you which is to include payment in full of the principal balance, together with interest, of the deed of trust covering the referenced property' (Trust deed No. 7177). LATD enclosed the original note and trust deed, and advised the bank that the unpaid balance of the note was $1,321.24 with interest paid to July 1, 1959.

"11. On August 19, 1959, LATD advised the investor to whom the trust deed note had been sold:

'We find it necessary to withdraw this Deed of Trust at this time.

This is according to our regular procedure . . .'

On August 20, 1959, LATD removed Trust Deed No. 7177 from the account of the investor, crediting the account $1,213. On September 2, 1959, LATD received from Security First National Bank of Los Angeles a check in the amount of $1,335. On September 9, 1959, the ledger account of the investor was credited wtih $1,335. On September 18, 1959, the entry was reversed. A handwritten notation on the ledger card states 'Payment posted to this account in error. See repurchase of same above.'

"12. The investor, of course, was not advised that LATD had appropriated the 'windfall' profit under circumstances which could not have resulted from mistake or inadvertence."

for some time by the appellants introducing the trust deed note into the account at an arbitrary price which would reflect earnings at ten per cent from the date the purchasers funds were received. This could be profitably done, of course, only where the purchase price to the "investor" bore no relationship to the price of the discounted note theretofore paid by appellants. The trust deed notes were purchased by appellants at discounts. Prices ranged from fifty-five per cent of the face amount on up to eighty or ninety per cent, or (at times, if the note bore on its face ten per cent interest) to one hundred per cent. The great majority were purchased at discounts of twenty to forty per cent. The price above the discount at which the notes were sold to purchasers varied dependent on the face amount, the rate of interest, the amount of monthly payment and the maturity date, all calculated to net ten per cent if held to maturity.

(f) There appears in evidence a memorandum dated May 29, 1959, which is illuminating as to the appellants' procedures with respect to such interest payments. The first two paragraphs read as follows:

> "As you realize, it has been the policy of the company in the past to accept funds from a customer for the purchase of trust deeds, and prior to actual assignment and ownership of a trust deed by a customer, to make an advance of the projected earnings, so that the customer could receive a check on the first of the month, after he had made his funds available.
>
> In view of the fact that this might possibly be construed as a payment of interest, instead of a

> mere advance against future earnings, which is charged against the free credit balance of the customer, it shall be the policy of the company to forward earnings checks to each customer only after a trust deed has been confirmed to the customer, and not rejected."

All the foregoing, together with the "Reserve for Losses" (Findings VII B, paras. 1-4) hereinbefore mentioned, requires us to hold that the appellants LATD and TD&MM have, by their representations made to the public, created and constituted the second trust deed notes herein considered securities subject to the provisions of the Securities Act. We find "a common enterprise" in which the appellants and the purchasers of second trust deed notes have an economic interest. We find that the economic welfare of the purchasers is inextricably woven with the ability of LATD to locate by the exercise of its independent judgment a sufficient number of discounted trust deeds, and the ability of LATD to subsequently meet its commitments to check, evaluate, supervise, and supersede. Eighty-five per cent of the "accounts" of the investors are in "debit balance." This means that eighty-five per cent of the investors or purchasers are making monthly deposits with LATD, or are having LATD apply collections on trust deed notes owned by purchasers to purchase of a new trust deed note. Title to such trust deeds is retained in LATD. The court below found, and we cannot hold it clearly erroneous, that

> "investors . . . [were] 'led to expect' the promised 10% earnings solely on the basis of the continued

ability of LATD to select, screen, appraise and acquire suitable trust deed notes, to service and collect the loan, and, if necessary, to handle foreclosure thereof, and if required by the investor, to repurchase or arrange for the resale of the obligation. There is an implied guarantee against loss. . . ." [Finding XIII, par. 2, p. 45.]

The terms of the offer, the plan of distribution, the economic inducements held out to the prospects, the results dependent on one other than the purchaser, the common enterprise, all combine herein to make the second trust deed notes "securities," as that term has been defined by the Supreme Court.

II. *Violation of Securities Law*

We need spend little time on the second question. If that which was here sold were securities, appellants were guilty of violations of the laws applicable to such securities. Admittedly such securities have not been registered with the SEC under the Securities Act, and neither LATD, TD&ME, nor TD&MM has, or is, registered as a broker or dealer in securities under the Securities Exchange Act. Admittedly, the United States mails were used to sell such securities.

III. *Fair Trial*

Appellants urge that they were denied a fair trial, and that the trial judge was prejudiced against the appellants.

(A) We have carefully read the record in regard to this charge. That there was a clash of personalities between appellants' counsel and the trial court is obvious. That the case was long and difficult, and was

required to be sandwiched in between other cases already in trial or thereafter reached for trial is likewise apparent.

We first consider the charge that the trial judge should have disqualified himself under the provisions of 28 U. S. C. §144. We find such charge to be without merit because of the following:

The affidavits in support of the motion to disqualify refer to five incidents. These incidents are—

(1) That the trial court required the appellants to attend a night session from 7:00 to 9:00 P.M. on November 4, 1958;

(2) That the trial court refused to grant a stay of the taking over by the Receiver it appointed on November 7, 1958;

(3) That the trial court, in appointing such Receiver and issuing a preliminary injunction on November 7, 1958, failed to follow local Rule 7 of the United States District Court for the Southern District, requiring service of documents on opposing counsel "unless the Court otherwise directs";

(4) That the trial court failed to follow local Rule 7 of that court on November 10, 1958, with respect to the proposed settlement of the findings of fact, etc., and shortened time of notice thereof;

(5) That on March 15, 1959, after the reversal by this court of the original decision, and upon the suggestion of appellants' counsel that the trial judge might desire to transfer the case for its retrial to another judge, he refused to do so, and expressed "with emotion and anger . . . that he was not a coward, was not running away from his duties," and that if appel-

lants believed him to be biased or prejudiced, if they would file their affidavits, he would file counter-affidavits, and the matter would be sent to the Presiding Judge of the Central Division of the Southern District of the United States District Court for California to determine the matter of his disqualification.

The first two incidents relate to matters entirely within the discretion of any trial judge. The next two incidents, at worst, indicate a mistake in law. The fifth, except for affiant's conclusion that the trial judge spoke with emotion and anger, indicates that the trial judge spoke and acted as he was required to do under the rules of that court, the case law, the canons of judicial ethics, and good common sense.

When appellants contend, as they do here, that these "affidavits charging bias and prejudice were legally adequate and sufficient . . . to require the trial judge to disqualify himself," they simply make an incorrect statement of the law. Appellants cite but two cases in support of their position that the affidavits, as a matter of law, required disqualification. Neither is in point on its facts. *Cf. Connelly v. U. S. District Court*, 9 Cir., 1951, 191 F. 2d 692,[5] and *Gladstein v. McLaughlin*, 9 Cir., 1955, 230 F. 2d 762.[6]

---

[5]In *Connelly*, the judge referred to a party before him as a Communist, and advised his attorney that he (the judge) was sorry the attorney was representing the client; admitted that the judge, as a United States Attorney, had prosecuted the party's alleged co-conspirators; and that he had stated the Communists hid behind the bill of rights, tried to destroy them, and believed the Communist party to be an illegal conspiracy.

[6]In *Gladstein*, the defendant judge had, *sua sponte*, issued an order to show cause why an attorney should not be disbarred, because of a contempt committed before a *different* court, in a Communist conspiracy trial.

We find in the affidavits no evidence of bias in the personal sense contemplated and required by the statute. *Eisler v. United States,* D.C. Cir., 1948, 170 F. 2d 273, 278. And see: *Loew's Inc. v. Cole,* 9 Cir., 1950, 185 F. 2d 641, 646 (76 F. Supp. 872); *Foster v. Medina,* 2 Cir., 1948, 170 F. 2d 632; *Price v. Johnson,* 9 Cir., 1942, 125 F. 2d 806, 811.

(B) Appellants urge that since the filing of the first affidavit, and the trial judge's refusal to disqualify himself, he has again evidenced bias and prejudice. Reference is first made to an affidavit referred to in, and ordered sealed by, our order of July 14, 1960. This affidavit, if the facts therein stated are true, indicates judicial temper and lack of judicial restraint, but it is expressed as to one of appellants' attorneys, not to all, and not to any party or its officers. So far as the record shows, no new motion to disqualify the trial judge was made below. While admittedly the statements charged by the trial judge, if true, even though not made in open court but at an informal conference in chambers, would have been better left unsaid, yet we cannot say such statements as a matter of law prevented a fair trial to the appellants in view of the plethora of evidence presented to us by the record herein which fully generally supports the court's findings and judgment.

(C) Appellants next seek to bolster the evidence of alleged bias and prejudice by urging that irrelevant and immaterial documents prejudicial to appellants' case were admitted. Here again, the admissibility of such documents lies largely within the discretion of the trial court. That is particularly true in a case of this kind.

where conflicting theories of what is and is not admissible were advanced by trial counsel. The one hundred and three documents listed in Appendix I attached to the brief of "certain appellants, including LATD& ME," seem all related to transactions in which some one or more of the corporate or individual defendants participated, and which related to the production of the securities here considered. Joint venture agreements, title policies, maps, brochures, income tax estimates, television scripts, and advertisements were all background to, if not strictly relevant and material to, the charges here made. The material could conceivably have aided the court in its attempt to understand a difficult and involved factual situation. The principal objection to many of the items in evidence is that they relate to matters occurring after the filing of the amended complaint. As we see it, such rulings, if technically in error (which we do not and need not here pass upon), would not necessarily constitute prejudicial error requiring reversal.

(D) Appellants' fourth charge of prejudice relates to the trial judge's alleged "severe, arbitrary and threatening conduct toward appellants' witnesses and counsel, and by contrast his courteous deference to S.E.C. witnesses and counsel."

Appellants' Appendix IV quotes those portions of the testimony wherein such a charge is allegedly supported. Appendix IV contains fifteen pages out of some 3,623 contained in the transcript. These fifteen pages refer to five incidents.

(1) In the first incident (November 3, 1959), Mr. Cuthbertson, one counsel for appellants, admitted to

having made "a sarcastic remark" while opposing counsel was addressing the court.. Upon being reprimanded by the court, Mr. Cuthbertson stated: "I am sorry." He should have been.

(2) In the second incident (November 18, 1959), Mr. Cuthbertson again interrupted the cross-examination of a defendant, telling him, "I think you have answered the question, Mr. Farrell." The court reprimanded Mr. Cuthbertson for so interrupting (but expressly excluded any reprimand of Mr. Foley or Mr. Ryan, other counsel for certain defendants). He advised Mr. Cuthbertson: "This court is going to run this court as a court of law and obey the rules, and Mr. Cuthbertson, you are going to have to find that out sooner or later."

(3) In the third incident on December 10, 1959, a witness evaded a direct answer to several questions by the counsel for the SEC. After an interruption by Mr. Cuthbertson (with an interpretation of the questioning, which may or may not have suggested an answer to the witness (Appendix IV, p. 8, lines 9-11)), Mr. Kennamer, counsel for SEC, referred to the "coaching" and "signaling" of witnesses he had brought before the court as hostile witnesses. The trial judge rejected the charge of "signals," accepted the charge of "coaching," and threatened certain counsel with "some punitive measure."[7] The record fails to show that any such punitive measure was formally taken.

---

[7] "Mr. Foley: Oh, your Honor, I certainly must deny——
"The Court: I will strike out the word 'signals' because I have to listen and I am not that observing. But I share your statement 100 per cent, Mr. Kennamer, and I say it applies to Mr. Cuthbertson and it applies to Mr. Foley, and I remonstrated

(4) The fourth incident, on December 11, 1959, was entirely innocuous, proving nothing.

(5) The fifth incident, on December 15, 1959, relates to an attempt by the SEC to discover who wrote an article published in the March 1959 issue of "Topics," the publication of the LATD, interpreting this court's opinion in the previous appeal.[8] Mr. Cuthbertson re-

---

with them before; and I want the record to show it does not apply to Mr. Bentley Ryan. The court resents it, and I think it is misconduct, and if it is going to happen again in the future, the court is not going to be fair; I am going to take some punitive measure against Mr. Cuthbertson and Mr. Foley for constantly violating the orders of this court and rulings of this court. I want that in the record. And I want in the record that Mr. Ryan has not participated in these false objections that there is no legal basis for, and made for one purpose only, to alert the witness and frighten the witness." (Appellants' Opening Brief, Appendix IV, p. 10.)

[8]The article as it appeared in its entirety reads as follows:

"Federal Court Clarifies Trust Deed & Mortgage Exchange Activities

"On Feb. 18, 1959, the U. S. Court of Appeals for the 9th Circuit, San Francisco handed down a unanimous decision which clarified many of the issues involved in the long drawn out dispute between L.A.T.D. & M. E. and the SEC.

"For over a year now we have been harassed by the SEC with their ill-considered and irresponsible charges against our company. They first attempted to intimidate us, then later resorted to smear tactics in their press releases. The ruling handed down by Chief Judge A. L. Stephens, Circuit Judge Wm. Healy, and Circuit Judge Stanley N. Barnes, held in pertinent part:

'This is a most unusual case in that there is no evidence in the record of any loss to any purchaser of any trust deeds sold by defendant Los Angeles Trust Deed & Mortgage Exchange.'

'Again we repeat that this record fails to disclose that any one person has been "defrauded," . . . out of any money. There are no "investors" or customers" complaining or a party to this law suit.'

'The record fails to support any findings of insolvency or bankruptcy of Los Angeles Trust Deed & Mortgage Exchange or Trust Deed & Mortgage Exchange.'

fused to take the responsibility for the article, although admittedly being present with three appellants and officers of LATD, David Farrell, O. J. Farrell and Thomas Wolfe, whose joint "product" it was. The court expressed himself as "shocked," and added: "I want that put in the record. . . . Especially shocked because Mr. Cuthbertson at one time was attorney for the SEC."

We see nothing in these five incidents recited that even suggests any improper attitude, ruling or action on the part of the trial judge, nor any "severe, arbitrary or threatening" conduct toward appellants or their counsel. We see courtesy but no deference to counsel for the SEC.

The incident occurring on April 21, 1960, in chambers, has heretofore been discussed.

(E) Appellants' fifth charge of bias and prejudice relates to rulings made as a result of discovery proceedings. If erroneous as matters of law, and if they constitute prejudicial error, they can be corrected on appeal. The dispute between the parties rests upon diverse interpretations of the court's various orders.

"The Court of Appeals has referred back to the District Court the task of now determining whether or not the Secured 10% Earnings accounts should be considered an 'investment contract.' If it is determined that it is an investment contract, it may be necessary for the company to register as security dealers with the SEC.

"All of the officers and employees of TD&ME are most pleased by this decision. We are indeed grateful to all of our friends and customers who have steadfastly remained confident in the integrity and financial stability of our company.

"To those of you who delayed making a decision as to starting or increasing your Secured 10% Earnings Account may we respectfully suggest that there's no better time than right now."

(Plaintiff's Ex. 180.)

and what they required of the appellants in the way of production of documents, and the extent of the cooperation required of its agents and employees. Appellants, after furnishing certain information to the SEC representative, refused to furnish additional information. The SEC sought to obtain sanctions against the appellants under Rule 37(b) (Fed. R. Civ. P.) in retaliation for such refusal. The SEC sought to prevent appellants from introducing evidence, and to strike appellants' answer.

We glean from the record that "an order was made on October 5th granting the Commission's motion under Rule 37(b)," and directing the Commission "to lodge a definitive order." This was done on October 9th, and an "in final form" order (dated October 12, 1959) was made by the trial court. Reference is made to that document in the Transcript of Record, pages 297 to 303. Its bulk weighs against its inclusion in this opinion. It suffices here to say it granted generally the relief sought by the SEC by its motion, under Rule 37(b), *i.e.*, it ordered certain facts urged by the SEC "to be taken as established;" it forbade appellants, "to oppose, by introduction of testimony or otherwise, the claims" of the SEC, or to support their defenses, or to introduce into evidence "any of the books records, etc." described in Schedule A attached to the motion of the SEC to which appellants had denied the SEC investigators access. It also struck certain material portions of the appellants' answer.

Appellants, under date of October 22, 1959, objected to the court's action in granting the SEC's motion under Rule 37 b) and on October 23, 1959, the court filed a long memorandum and order granting appel-

lants' motion to vacate the orders previously made under Rule 37(b). This is again too bulky to include herein in full.

Such latter action of the trial court, far from showing bias and prejudice, indicated a desire to follow the law; to correct any error involved in the making of the original order, if one had been made; and to permit the appellants to have a fair trial. The record shows that between October 5th and October 23rd, 1959, there were six days of trial—October 6th, 7th, 8th, 13th, 20th and 22nd. No testimony was taken on the 13th, 20th or 22nd. On the other days the court heard appellee's witnesses, Aidel Korenberg, an investor, James West, Jr., an investor, and Stanley C. Marks, a defendant and adverse witness called by the SEC.

At no time during the giving of testimony on the 6th, 7th or 8th of October 1959, can we find any recognition by either the court or any counsel that any attorney or any party was laboring under any disability created by the October 5, 1959, order. If counsel for the appellants knew of it, they did not mention it. Instead they requested and obtained a suspension of the trial (to which the trial court readily assented) until they could apply to this court for a writ.

If we assume there was error in the October 5th (or 9th, or 12th) order made by the trial judge, such error was corrected by his order of October 22, 1959. And we find no prejudice existed with respect to appellants, because in no way or instance were they prevented, during the short-lived existence of the Rule 37(b) order from participating fully in the trial. They offered no evidence (inasmuch as the appellee's case

was going in at that time) and hence none was refused. We can find no personal bias or prejudice against appellants with respect to the Rule 37(b) order, nor in the circumstances surrounding its creation and termination.

(F) Appellants' sixth, seventh and eighth charges of bias and prejudice (discussed collectively by appellants) relate to the trial court's action in three instances of either allegedly signing papers presented by the SEC during the trial without giving the appellants proper notice, or acting *sua sponte* on various matters. (Fed. R. Civ. P. 5(a), 6(d), 43(e) and Rules 3(b), 3(d), 7(a) and 18(a) of the Rules of the United States District Court, Southern District of California.)

While we cannot condone the several instances where matters were heard on shortened notice without order shortening time having been previously made, we fail to note any instance wherein appellants were denied additional time to prepare for such hearings when they requested it. No claim is made that any specific order or ruling was error, but that in the aggregate such actions showed bias and prejudice. We do not believe a thorough reading of the record substantiates such a position. We have been referred to no errors in procedure which in any sense could be ruled to constitute prejudicial error. The court did nothing in shortening time it could not have done had a request and order been made shortening time, as the rules permit. *Cf. Alexander & Co. v. Martz*, 1930, 107 Cal. App. 277, 279.

(G) The ninth ground of alleged bias and prejudice is that Messrs. Cuthbertson and Foley were prohibited by court order from participating in the trial

on October 6th, 7th, 8th and 13th, 1959. If such a specific order was made, it was apparently never enforced.

As we have seen, no testimony was taken on October 13th, 1959. But at that short hearing, Mr. Cuthbertson spoke five times and Mr. Foley seven. The trial judge indicated his willingness to grant a stay requested by appellants, but instead suspended the trial until the matter then pending in this court could be heard.

On October 6th, 1959, Mr. Foley first spoke to the court at some length (Rep. tr. Vol. I, pp. 4-14), and thereafter made an opening statement (Rep. tr. Vol. I, pp. 16-32). Mr. Cuthbertson then spoke (Rep. tr. Vol I, pp. 34-40). Thereafter, the first witness, Stanley C. Marks, was called and testified. Mr. Foley objected more than once to the receipt of documents in evidence. Mr. Cuthbertson joined in voicing objections. Both counsel were granted a continuing objection to all matters relating to dates following the filing of the amended complaint. Several of Mr. Foley's objections were sustained, both as to the form of the questions, and on the substantive law of privilege. All this occurred before the noon recess. Thereafter both Mr. Foley and Mr. Cuthbertson participated in the defense. When Mr. Foley made no objection as such, but stated: "I would like to have the question [of Mr. Kennamer] rephrased,"—the trial judge granted Mr. Foley's request, and required counsel for the SEC to reframe the question. At one point the court delayed the hearing while Mr. Foley was on telephone.

On October 7th, 1959, the same procedure appears to have been followed. Both Mr. Cuthbertson and Mr.

Foley cross-examined the witness, Mrs. Korenberg, at some length.

On October 8th, 1959, both Mr. Foley and Mr. Cuthbertson again participated in the trial proceeding. and cross-examined at some length the witness West.

We are at a loss to see how, under such circumstances, appellants can charge they "were made spectators." There is no truth and no merit whatsoever in such an assignment of alleged error.

(H) Appellants' tenth assignment of bias and prejudice (marked No. 11 in their brief) is the charge that "the adjudication against the appellants was made before the trial began and before any evidence had been received in the case." This charge rests on appellants' conclusion that because the final judgment and findings are similar to the recitals contained in Schedule B attached to the motion made by the SEC to obtain an order pursuant to Rule 37(b) that "Certain facts claimed by the Securities and Exchange Commission shall be taken as established." Another second logical explanation would be that the evidence produced at the trial proved the SEC's case in all respects. Identity of language between what a litigant claims prior to trial and what the court finds as a fact after trial is no proof whatsoever that the trial judge prejudged the facts; or had made any decision prior to the completion of all testimony and the closing of the case.

In concluding our observations on whether or not appellants have had a fair trial, we can only say that a reading of the transcript of a long and protracted trial has convinced this court that they have had. We find no deprivation of property without due process of law.

IV. *Errors in the Admission of Evidence*

In but one instance does the brief of appellants represented by Mr. Cuthbertson challenge the rejection of evidence. That related to the witness West. The question was asked on cross-examination:

> "Will you examine that brochure and point out to me, if you can, anything in that brochure which indicates that the company as such would pay any interest or earnings to its customers, other than such as might be earned on trust deeds sold to the customers?"

Objection was made, and sustained. The objection was made on the grounds that the question was argumentative, and unfair to the witness. A better objection would have been that the brochure (Plaintiff's Exhibit 32) was already in evidence, spoke for itself, and was itself better evidence of what was contained therein than any conclusion of the witness on that subject. Perhaps counsel for the SEC would have raised such a ground, had he not been interrupted by the court's ruling in his favor. But in any event, the rejection of evidence, if clearly inadmissible on any ground whether urged or not, is not prejudicial error.

Counsel states that Mr. West was contending that he believed himself entitled to interest. That is correct. But Mr. West had also testified he had been told by Mr. Stark, the appellant LATD's vice president, that he would receive principal and interest every month.

> "Only if you deposited $3,000 or more would we remit the principal and interest to you that you can accumulate. Every month we will send you a confirmation sheet showing you the accumulation of your investment."

When West paid defendant $2,500 on the 21st of November, 1958, Mr. Stark promised to pay him interest "from the first of the month." West received a confirmation of a sale of a first trust deed on December 31, 1958. This he rejected. He received another dated March 16, 1959, which was again rejected by him. A third confirmation of sale, dated June 1, 1959, West also rejected. West then demanded the return of his $2,500, and received it. He then asked for his interest, and he was told that not having made a purchase of any deed of trust, he was not entitled to any interest, and this because "it was against the law."

West told Stark that "his [West's] monthly statements, [received from appellants, Plaintiff's Ex. 17] showed an increase in earnings and this what he [West] should receive."[9] West had received a photostatic

---

[9]West's May 31st, 1959 statement showed the following:

"Condensed Summary"
TRUST DEED
&
MORTGAGE
EXCHANGE

* * * * * * * * *

2267

"*James &
Marilyn J. West, Jr.
*121 Via Lacumbre.
San Rafael, California

Date	* * *	Total Cash Received To Date	Combined Earnings and/or Projected Accruals	Estimated Liquidation Value of all Assets in Your Account
Apr. 30 '59		2,500.00*		2,627.64
May 31 '59			21.90	2,649.54

"WE APPRECIATE YOUR ACCOUNT: You may add to it at any time. Just mail in your check for any amount and we will apply it to your account. The right hand column is a computed summary of what we con-

copy of his master ledger card. That master ledger card appears in evidence (Plaintiff's Ex. 18).[10]

In view of the oral representations allegedly made to Mr. West by appellants' representative,[11] and the written documents hereinabove mentioned and intro-

---

sider to be the cash value of your account as of this date. Your actual account consists of the cash, notes and earnings completely detailed on our ledger card, a copy of which will be forwarded upon request. You already have the basic details of each transaction in the confirmation sent you at the time of sale."

(Plaintiff's Ex. 17.)

[10]Combining for ease of copying the first two pages of Plaintiff's Exhibit 18, we see:

"James West, Jr. and — Account 2267
Marilyn J. West — 2001
121 Via Lacumbre
San Rafael, California
Husband & wife, as joint tenants.

Collect & service notes.
Apply all princ. & int.

Date	Receipt, Check, or Collection Number	Customer's Cash Rec'd This Month	Cash Paid to Customer This Month	Total Cash to Date	Combined Earnings and/or Projected Accruals	Estimated Liquidation Value of All Assets in Your Account
Nov 25 '58	7,578.00	2,500.00		2,500.00*		2,500.00
Nov 30 '58					20.83	2,520.83
Dec 31 '58					21.01	2,541.84
1-31-59					21.18	2,563.02
2-28-59					21.36	2,584.38
3-31-59					21.54	2,605.92
4-30-59					21.72	2,627.64
5-31-59					21.90	2,649.54
6-12-59	7563		2500.00	0*		149.64
ck 7653 to close account						0

[11]The record abounds with representations made by appellants' employees which the corporate defendants' officers disclaim. Merely as an example, of the reference, even in 1959, to appellants' "investment brochure explaining "types of investment." (Letter of March 12, 1959, to James T. Penning. Plaintiff's Ex. 59A.)

duced into evidence; the question as to what West's interpretation of the language contained in the brochure (Plaintiff's Ex. 32) may have adds little to the proof of this case. We hold the court's ruling sustaining the objection to the question with respect to Exhibit 32 was not error, and by no manner of thinking could it be deemed prejudicial error.

V. *The Appointment of a Receiver*

We next come to the most difficult point in this appeal, the appointment of the Receiver with instructions to liquidate the corporate appellants.

The SEC is not an interested party to this litigation in the sense that it has any financial interest in how the appellant corporations are operated. No dissatisfied customer or investor is a party plaintiff. The SEC must therefore first look to the statutory authority given it by its creator, the Congress.

Title 15 U. S. C. §§77a to 77aa covers the issuance of Domestic Securities. Section 77b first defines "security," and as we have heretofore determined, what appellants here sold constitutes a security—the equivalent of an "investment contract," for want of a better classification. Section 77e makes it unlawful for any person to use the mails to sell any unregistered security through the use of any prospectus. It was here stipulated by all appellants that the mails had been used by appellants. Section 77 l creates for a violation of §77e a civil liability *in favor of the person purchasing* the security. As we have seen, no such person appears herein as a party. Section 77s authorizes the Commission to make necessary rules and regulations, and to carry out investigations. Section 77t(b) authorizes

the Commission to bring an action "to enjoin such acts and practices" as are deemed a violation of the provisions of subchapter I, relating to Domestic Securities . . ." and upon a proper showing, a permanent or temporary injunction or restraining order shall be granted without bond."

Also, §77t(c) provides:

> "Upon application of the Commission the district courts of the United States and the United States courts of any Territory, shall also have jurisdiction to issue writs of mandamus commanding any person to comply with the provisions of this subchapter or any order of the Commission made in pursuance thereof."

Thus, we see that 15 U. S. C. §77t(b) (and the substantially identical §21(e) of the Securities Exchange Act of 1934 (15 U. S. C. §78u(e) is the basis of the authority for the SEC's suit herein.

In view of our holding that that which was sold by appellants herein constituted a security; that the district court trial judge was under no duty to disqualify himself; that he was not prejudiced nor biased against appellants personally; that the appellants were guilty of violations of the Securities Act of 1933 and the various Securities Exchange Act provisions described in said judgment; that the appellants had a fair trial; and, that there was no error in the admission of evidence, as charged, we have no doubt as to the authority of the SEC to obtain the restraining orders and injunctions set forth in parts I to V, inclusive, of the judgment heretofore entered, and appealed from herein, or other necessary writs to require compliance with the Securities and Securities Exchange Acts.

This brings us to the question as to whether the court below had authority to appoint a Receiver of LATD and TD&MM.

The sale of any securities without the approval of SEC, provided they are sold in interstate commerce, or by use of the United States mails, is per se unlawful. In addition, there is sufficient evidence in the record to support the trial court's findings of fact and conclusions of law that the appellants are guilty of unlawful and deceitful and fraudulent acts.

There can be no question, for example, that the replacing of defaulted mortgages sold to investors from the "warehouse account" would eventually, if not immediately, create serious problems as to the values attributed to such "warehouse account." The practice of valuing the repurchased second trust deeds, not at the price originally paid by appellants to the original makers, but at the revised and higher prices at which those discounted trust deeds were repurchased by the appellants from dissatisfied purchasers (frequently after the occurrence of a default in principal and interest payments), could only result in inflated, unrealistic, inaccurate and, at times, a fraudulent evaluation of the appellants' assets. It is unnecessary to mention again the various badges of fraud and deceit previously touched upon in this opinion.

We agree with appellee that under such circumstances it might well have been an abuse of discretion for the court below to have declined to grant a decree enjoining appellants from continued violations of the registration and anti-fraud provisions of the Securities Act. We need not reach any question of abuse of discretion, for the injunctive provisions were by statute provided

for, to be exercised by the trial court in a proper case. And in passing upon whether the trial court acted within its judicial discretion, we must interpret every intendment in favor of the legality of the court's action.

Nor are we impressed with appellants' argument that they have reformed; that their latest brochures and advertisements have eliminated much that was originally put out, and which was admittedly either outright false, or inaccurate, or capable of an interpretation by unwary investors contrary to the actual facts.

> "A trial court's wide discretion in fashioning remedies is not to be exercised to deny relief altogether by lightly inferring an abandonment of the unlawful activities from a cessation which seems timed to anticipate suit." *United States v. Parke Davis & Co.*, 1960, 362 U. S. 29, 48.

And *cf: S. E. C. v. Culpepper*, 2 Cir., 1959, 270 F. 2d 241, 249.

Nor are we inclined to modify the scope of injunctive provisions with respect to the securities affected by the court's order. *NLRB v. Express Publishing Co.*, 1941, 312 U. S. 426; *Hillsborough Investment Corp. v. S. E. C.*, 1 Cir., 1960, 276 F. 2d 665.

With respect to the authority of the trial court to appoint the Receiver to take over assets in order that they might not be dissipated, or wasted, and so that the status quo may be maintained, we are referred by appellee to *Porter v. Warner Holding Co.*, 1946, 328 U. S. 395, 398; *Mitchell v. De Mario Jewelry*, 1960, 361 U. S. 288, 291, as the cases upon which it principally relies. The first relates to the Emergency Price Control Act of 1942; the second to the enforcement of

Fair Labor Standards Act. Neither is directly in point in a case of this kind, instituted under the Securities Exchange Act and the Securities Act, containing somewhat different language. Nevertheless, we conclude there exists under the latter acts the power and authority in the SEC to bring this action, and power in the district court, as a court of equity, to appoint a receiver to maintain in status quo the assets of the appellants and the respective purchasers of the second trust deeds until such time as the appellants can comply with the law, or dissatisfied trust deed holders or other creditors may take the necessary steps to prove by regular and ordinary methods that the several appellants are insolvent and/or unable to meet their obligations.

While this is apparently a case of near first impression in a federal appellate court, and the Supreme Court has not as yet had an opportunity to rule on the precise question here involved, the First Circuit has ruled that authority to appoint such a receiver exists in the court in an action instituted by the SEC, under the peculiar circumstances existing in that case, although totally dissimilar to those here existing. *Aldred Investment Co. v. S. E. C.*, 1 Cir., 1945, 151 F. 2d 254 and *S. E. C. v. Fiscal Fund, Inc.*, D. Del., 1943, 48 F. Supp. 712. And we are referred by appellee to the following unreported cases: *S. E. C. v. Willcox*, N. D. Ind., 1935; *S. E. C. v. Colonial Trading Co.*, N. D. Nev., 1935; *S. E. C. v. Lubbe*, S. D. Ill., 1943; *S. E. C. v. Hempstead*, D. C. R. I., 1944; *S. E. C. v. Woodman*, D. Mass., 1944; *S. E. C. v. Adams*, N. D. Ill., 1949; *S. E. C. v. Barrett Herrick & Co.*, S. D. N. Y., Civil Action No. 112,936; *S. E. C. v. Zippin & Co.*,

N. D. Ill., No. 53C53; *S. E. C. v. Investment Brokers of New Jersey*, N. J., 1960; *S. E. C. v. Arthur C. Costello*, E. D. Mo., 1960.

We see no reason why the fact that the Securities Act establishes a right which an individual litigant may enforce *necessarily* strips the SEC from having similar rights as a litigant. *Cf. Deckert v. Independent Shares Corp.*, 1940, 311 U. S. 282.

Nor are we convinced that because the SEC has asked for authority from the Congress to broaden its statutory powers, and that the Congress thus far has not seen it proper to do so, means that the broad equitable powers of the federal courts *cannot encompass necessary ancillary* relief, such as the appointment of a receiver, assuming the need for such exercise of *ancillary power* exists.

We conclude, therefore, as the Supreme Court has stated with respect to other regulatory statutes, that the Congress must be taken to have acted cognizant of the historic power of equity to provide complete relief in the light of statutory purposes. As the Supreme Court long ago recognized, there is inherent in the courts of equity a jurisdiction to give effect to the policy of the legislature. And see *Riehle v. Margolies*, 1929, 279 U. S. 218. Hornstein, A Remedy for Corporate Abuse, 40 Colum. L. Rev. 220, 224 (1940). *View Crest Garden Apartments, Inc. v. United States*, 9 Cir., 1960, 281 F. 2d 844, and cases cited in note 2; *Totten v. Harlowe*, D. C. Cir., 1937, 90 F. 2d 377;

Garden Homes v. United States, 1 Cir., 1952, 200 F. 2d 299.

We next consider the power of the court to order the Receiver to liquidate the respective corporate defendants.

We are referred to no authority which authorizes the court to require the orderly or any liquidation by the Receiver of LATD, TD&MM, and/or TD&ME (if that corporation should hereafter be included within the receivership), when there has been no bankruptcy proceedings. The trustee in bankruptcy is the person to liquidate, if that be necessary, under the usual and ordinary supervision of a Referee in Bankruptcy.

The trial court has found insolvency in the bankruptcy sense, but there is no apparent reason here why the violation of the Securities Act and the Securities Exchange Act should lead to a different type of final liquidation than that which is had for the normal corporate bankrupt. In true bankruptcy, procedures are better geared for creditors and depositors to give them a day in court and protect their rights. Also, the Bankrupcy Act has provisions for reorganization.

In our judgment the receiver here should be regarded as one pendente lite. Obviously, on motion of appellants, the district court should not release the appellants from the receivership until they have complied with the registration provisions of the Acts of Congress which they have offended.

It is appreciated that the conservator type of receivership which we have insisted upon is not well adapted

to a business the very essence of which is promotion and, apparently, depends on a constant inflow of new business. However, a receiver does seem required. But, we are not yet willing to order liquidation. That would establish perhaps generally a special additional penalty for failure to comply with the two Acts of Congress with which we were here concerned and we doubt that this was within the contemplation of Congress. We do not hold that liquidation can not ever be effected. Possibly some circumstances might arise which would justify such a result. And, it could even eventuate in this case, but we hold "not now."

The judgment of the trial court is therefore modified by striking therefrom the words on page 10 beginning at line 17:

> "with directions to accomplish the orderly liquidation of Los Angeles Trust Deed & Mortgage Exchange and Trust Deed & Mortgage Markets."

This is as it was heretofore modified by our previous stay order. In all other respect the judgment herein appealed from is *affirmed*, and the matter remanded to the district court for further proceedings in accordance with this opinion.

(Endorsed) Opinion Filed Nov. 23, 1960.
Frank H. Schmid, Clerk.

APPENDIX VII.

Court of Appeals Order of January 10, 1961.

United States Court of Appeals for the Ninth Circuit.

Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Markets, David Farrell, Oliver J. Farrell, Roy A. Bonner, Thomas Wolfe, Jr., and Stanley C. Marks, *Appellants*, vs. Securities and Exchange Commission, *Appellee*. No. 16,995. Order Jan. 10, 1961.

On Appellants' Petition For Rehearing

Before: Chambers, Barnes and Jertberg, Circuit Judges.

Appellants have filed a petition for rehearing. On it we take the following action:

1. The slip sheet opinion is corrected to show that the last line of the opinion on page 18 should appear at the end of paragraph numbered "(3)".

2. The opinion is modified by adding the word "nonexempt" before the word "securities" in the first sentence, third paragraph, page 28 of the slip opinion; the words "the approval of" appearing therein are to be stricken, and the words "an effective registration with" substituted therefor, so that that sentence will read: "The sale of any nonexempt securities without an effective registration with the SEC, provided they are sold in interstate commerce, or by use of the United States mails, is per se unlawful."

3. On July 6, 1960, the receiver theretofore appointed by the District Court petitioned for authority to accomplish liquidation. As part of an opposition thereto,

an affidavit was filed by David Farrell, president of Los Angeles Trust Deed and Mortgage Exchange, reciting an alleged incident at a conference in the chambers of the trial judge on April 21, 1960. It was not an affidavit under the statute for disqualification of the judge, and it was not so denominated. And apparently the affidavit has never been filed in the District Court. Further, if disqualification were its purpose, it was hardly timely then.

When the affidavit was before us, it appeared that the trial judge, Judge "A", was out of the case, and so on July 14, 1960, we said:

> "Inasmuch as the case does not appear to be with Judge 'A', we shall now take notice of the three-page affidavit only to the extent of ordering it sealed up, to be unsealed only on order of this court."

In their petition for rehearing, appellants complain bitterly that Judge "B," who had taken over the case during an absence of Judge "A" from the district, has returned the case to Judge "A" and sent along with it later companion cases involving Los Angeles Trust Deed and its officers. (The subsequent cases are apparently going along with this case in the District Court under that court's "low number rule.")

This retransfer and the transfers of the later cases are not completely understood by us. While we did direct a modification of the original judgment, any modification thereof would be essentially clerical and ad-

ministerial, not requiring any particular knowledge of the trial which would be peculiar to the trial judge.

We would not condone an effort to shop for a judge pleasing to a party. But on the other hand we do say at this juncture the better course of wisdom would be for Judge "A" to let some other judge take over the cases. Judge "A" just should not feel it his duty, after he has some inkling that a violent attack has been made upon him, to preside over the cases as long as some other judge can be found, provided he is at a good stopping point. And we think he is there. Since Judge "B" apparently no longer desires to handle the cases, perhaps a third judge could be found.

We have not said that affidavits for disqualification could not be filed at this juncture in this, the original case, or in the companion cases (which have not been before us except as they are here imported).

While a mere verified conclusion that a judge is biased and prejudiced is not enough under the federal system to disqualify, still if the affidavit is sufficient on its face it is not open to the trial judge to file a traverse. We suggest possibly on reconsideration Judge "A" may feel disposed to refer this case and its related cases to the Chief Judge of the District for reassignment.

It is suggested that the filing of any affidavit of disqualification may not be necessary and that Judge "A" will see fit to follow the course of Judge McLaughlin, of which we take judicial notice, when he

stepped aside after our decision in *Gladstein vs. McLaughlin,* 230 F. 2d 762.

After careful consideration, in our opinion on the merits we held that appellants had a fair trial. But somewhere along the road decorum has faltered.

We have not ruled that the affidavit which we have sealed is true. We have not determined that if Judge "A" became provoked on some day he did not have reason to be provoked. We do not know. And we seek to avoid the necessity of finding out.

4. The request that this court revoke its order of July 14, 1960, sealing a certain document, is presently denied.

5. The petition for a rehearing is denied.

6. The suggestion that there be a hearing en banc is rejected.

Richard H. Chambers,
Stanley N. Barnes,
Gilbert H. Jertberg,
Circuit Judges.

(Endorsed) Order on Appellants' Petition for Rehearing. Filed Jan. 10, 1961.

Frank H. Schmid, Clerk.

APPENDIX VIII.

Section 20(b) and Section 20(c) of the Securities Act of 1933.

Section 20(b) and Section 20(c) of the Securities Act of 1933 (15 USC 77t(b) and (c)).

"Sec. 20(b). Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this title, or of any rule or regulation prescribed under authority thereof, it may in its discretion, bring an action in any district court of the United States, United States court of any Territory, or the United States District Court for the District of Columbia to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General who may, in his discretion, institute the necessary criminal proceeding under this title. Any such criminal proceeding may be brought either in the district wherein the transmittal of the prospectus or security complained of begins, or in the district wherein such prospectus or security is received."

"Sec. 20(c). Upon application of the Commission the district courts of the United States, the United States courts of any Territory, and the United States District Court for the District of Columbia, shall also have jurisdiction to issue writs of mandamus commanding any person to comply with the provisions of this title or any order of the Commission made in pursuance thereof."

APPENDIX IX.

Section 22(a) of the Securities Act of 1933.

Section 22(a) of the Securities Act of 1933 (15 USC 77v(a)).

"*Sec. 22(a).* The district courts of the United States, the United States courts of any Territory, and the United States District Court for the District of Columbia shall have jurisdiction of offenses and violations under this title, and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this title. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the *offer or* sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 225 and 347). No case arising under this title and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts."

APPENDIX X.

SEC Motion Filed September 2, 1959.

"On the basis of the refusal of the defendants Los Angeles Trust Deed & Mortgage Exchange and David Farrell, its President, directly and through their respective counsel, to comply with the Order of this Court entered on June 10, 1959, pursuant to Rule 34 of the Federal Rules of Civil Procedure, the Securities and Exchange Commission respectfully moves the Court as follows:

I.

"That the facts set forth in a Statement of Certain Facts Claimed by the Securities and Exchange Commission, which are incorporated in Schedule "B" appended hereto, shall be taken as established for the purposes of this action.

II.

"That the defendants Los Angeles Trust Deed & Mortgage Exchange and David Farrell, its President, shall not be allowed upon the trial of this action to oppose, by the introduction of testimony or otherwise, the claims of the Securities and Exchange Commission set forth in Counts I, II, III, IV and V of the Amended and Supplemental Complaint for Injunction and for Appointment of Receiver, and that said defendants shall not be allowed to support, by the introduction of testimony or otherwise, the defenses to Counts I, II, III, IV or V of said Complaint as asserted in the Answer of Defendants to said Complaint filed on December

2, 1958, nor to support, by the introduction of testimony or otherwise, the First, Second, Third or Fourth Affirmative Defenses set forth in said Answer, nor to introduce in evidence, either in opposition to such claims of the Commission or in support of such affirmative defenses, any of the books, records, accounts, financial statements or documents of said Los Angeles Trust Deed & Mortgage Exchange described in Schedule "A" appended hereto, to which said defendants have denied the Commission access, in defiance of and in violation of the Order of this Court entered on June 10, 1959.

III.

"That as to the defendants Los Angeles Trust Deed & Mortgage Exchange and David Farrell, its President, the entire Answer of Defendants to the Amended and Supplemental Complaint for Injunction and for Appointment of Receiver be stricken, with the exception of introductory paragraph numbered 3."

(The remainder of the motion is omitted as not being material to the issues here involved.)

APPENDIX XI.

Plaintiff's Exhibits and Objections Noted in Reporter's Transcript.

Plaintiff Exhibit No.	Document Described	Objection Noted Reporter's Trans.
36	LATD warehouse list from 5/31/59	2784:9
43-C	Letter Western Title Co. dated 9/18/59	2778:30
50	LATD warehouse control dated Sept. 1959	2785:4
51	LATD warehouse control dated 9/25/59	3450:16
52	13 LATD T/D warehouse checks 9/18/59	2786:2
59	James T. Penning file from July 1959	2788:1
59-A	James T. Penning papers from July 1959	2790:7
77	SEC prepared schedule from 4/59 to 10/59	2809:17
78	LATD stockholders schedule	2780:2
80	Ben Griswold transaction Sept. 1959	1502:20
81	James E. Eppley transaction from 2/20/59	1562:14
82	Elmer L. Handorf transaction from Sept. 1959	1606:6
86-A	Letter Newport-Bal. Sav. & L. April 1959	1620:24
86-B	Letter Nectar Homes, Inc. May 1959	1620:24
86-C	LATD Group buy order June 1959	1620:24
87	Alfred Linke transaction Oct. 1959	1639:20
88	Walter Warkow transaction Oct. 1959	1655:11
89-A	Goheen transaction Jan.-Feb. 1959	1690:14
89-B	Goheen transaction Jan.-Feb. 1959	1690:14
89-C	Goheen transaction Jan.-Feb. 1959	1690:14
91	LATD house organ Topics March 1959	1701:6
93	Div. of Corps. Desist & Refrain order Feb. 1959	1713:23
96	SEC prepared schedule from April 1959	2757:14
97	SEC prepared schedule from April 1959	2757:14
98	SEC prepared schedule from May 1959	2757:14
99	SEC prepared schedule from March 1959	2757:14
100	SEC prepared schedule from March 1959	2757:14
101-A	Appraisal of property Oct. 1959	1824:4
101-B	Appraisal of property Oct. 1959	1824:4

Plaintiff Exhibit No.	Document Described	Objection Noted Reporter's Trans.
101–C	Appraisal of property Oct. 1959	1824:4
102	Appraisal of property March 1959	1839:2
103	9 LATD buy orders & confirmations Mar. 1959	1839:13
105	LATD buy order March 1959	1848:2
106	Inspection report March 1959	1849:7
107	Appraiser's report Sept. 1959	1850:24
108	Inspection report Oct. 12, 1958	1852:5
109	Appraiser's report March 1959	1855:25
110	Appraisal of property Oct. 1959	1857:7
111	2 Appraisals of property Oct. 1959	1859:17
112	Appraisal of property undated	1862:2
113	Goheen-Farrell agreement Sept. 1958	1901:4
114	Goheen-Farrell agreement Nov. 17, 1958	1918:7
115	Cimarron ranch agreement Jan. 1959	1921:8
117	Check to Merced Title Co. Jan. 1959	1967:22
119	Marin Capital Co. trust deed Dec. 1958	1993:8
120	Goheen-Farrell Agreement Jan. 15, 1959	1994:8
121	Goheen rescission agreement June 22, 1959	2009:12
122	Hyacinth Homes agreement Sept. 1958	2025:14
123	Burrell's joint venture Aug. 1958	2027:13
124	Papers relating to Reedlands March 1959	2051:2
125	Papers relating to Reedlands March 1959	2056:22
126	Map of Reedlands undated	2060:15
127	Map of Reedlands undated	2067:4
128	Howard Rhodes letter April 11, 1959	2088:9
129	Farrell letter to Rhodes April 11, 1959	2089:1
130	Hawkins ranch confirmation Oct. 1959	2122:16
130–A	Title policy, Hawkins ranch Sept. 1959	2127:17
131	Letter from Hawkins executors Sept. 22, 1959	2781:10
131–A	Copy letter to Leo J. Shanahan ?	2782:12
132	3 confirmations Saugus-Newhall 1959	2134:11
132–A	3 confirmations Newhall Ind. 1959	2135:6
132–B	Confirmations & title policy Tract 1078 1959	2135:17

Plaintiff Exhibit No.	Document Described	Objection Noted Reporter's Trans.
132-C	Confirmations Tract 1079 1959	2136:14
132-D	Confirmations & title policy, Saxonia 1959	2137:3
132-F	Confirmations & title policy, Quigley 1959	2138:4
133	Agreement, Villa Nipomo Tract Sept. 1959	2142:4
134	11 buy orders Villa Nipomo Tract Sept. 1959	2148:18
135	David Farrell bankruptcy papers 1949	2165:6
136-A	Confirmation of sale to Masada June 1959	2194:13
136-B	Payors record Masada T. D. April 1959	2215:8
137	Farrell letter to Mercola April 1959	2206:13
144	Letter received by Ugene Blaloch Sept. 1959	2313:22
150	Letter from Rhodes to David Farrell Dec. 8, 1959	2444:4
151	Letter from Rhodes to Delite Dec. 10, 1959	2783:5
152	Cal. Div. of R. E. Accusation June 1959	2586:5
153	Harris-Steele agreement 1959	2588:21
154	Farrell letter to Sylvan Allen Jan. 1960	2597:7
155	Harris-Steele, Prestige agreement May 1959	2602:16
156	Trust Agreement May 1959	2604:16
157	Harris-Steele agreement July 1959	2606:4
158	Colorado brochure Oct. 1959	2608:21
159	Pacific Plan brochure 1960	2628:15
160	SEC schedule of 148 T. D.'s 1960	2806:24
166	SEC schedule net capital computations 1960	2842:6
167	LATD 1959 income tax estimate 1960	2922:11
168	SEC schedule re 3/31/59 fin. stat. 1960	3013:6
174	LATD television scripts 1960	3444:22
175	LATD television scripts 1960	3445:10
176	LATD newspaper advertisements 1960	3446:19
177	LATD mailing pieces 1960	3446:19
178	LATD newspaper advertisements 1960	3447:3
179	SEC schedule re windfall profits 1960	3463:14
180	LATD "Topics" 1959 and 1960	3464:23
181	Brochure TD&MM 1959	3465:16

ILE COPY

OFFICE SUPREME COURT, U.S.
FILED
APR 26 1961
JAMES R. BROWNING, Cle

No. 854

In the Supreme Court of the United States

OCTOBER TERM, 1960

LOS ANGELES TRUST DEED & MORTGAGE EXCHANGE, ET AL., *Petitioners*

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

ARCHIBALD COX,
Solicitor General,
Department of Justice,
Washington 25, D. C.

WALTER P. NORTH,
General Counsel,

DAVID FERBER,
Assistant General Counsel,

[illegible] KENNAMER, JR.,
[illegible] A. DUDLEY,
Attorneys,
Securities and Exchange Commission,
Washington 25, D. C.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statutes and rules involved	2
Statement	3
Argument	7
Conclusion	14
Appendix	15

CITATIONS

CASES:

Aldred Investment Trust v. *Securities and Exchange Commission*, 151 F. 2d 254	11
Deckert v. *Independent Shares Corporation*, 311 U. S. 282	11
Gordon v. *Washington*, 295 U. S. 30	12
Kelleam v. *Maryland Casualty Company*, 312 U. S. 377	12
Mitchell v. *DeMario Jewelry*, 361 U. S. 288	11
Porter v. *Warner Holding Company*, 328 U. S. 395	11
Securities and Exchange Commission v. *W. J. Howey Company*, 328 U. S. 293	6, 7, 8, 9
Securities and Exchange Commission v. *Joiner Corporation*, 320 U. S. 344	6, 7, 8, 9
Securities and Exchange Commission v. *Los Angeles Trust Deed & Mortgage Exchange*, 24 F.R.D. 460	12
Securities and Exchange Commission v. *Howey Company*, 151 F. 2d 714 (C. A. 5), reversed, 328 U. S. 293	8

STATUTES AND RULES:

Bankruptcy Act, 30 Stat. 544, as amended, Section 11(c), 11 U.S.C. 29(c)	11
Securities Act of 1933, 48 Stat. 74, as amended, 15 U.S.C. 77a, *et seq.*:	
Section 2(1)	6, 10, 15
Section 5	15
Section 17(a)	16

Page

Section 20(b) 2, 11
Section 22(a) 2, 11

Securities Exchange Act of 1934, 48 Stat. 881, as amended, 15 U.S.C. 78a, *et seq.*:
Section 3(a)(10) 6, 10, 16
Section 15(a) 17
Section 15(c)(1) 17
Section 27 ..... 11, 17

28 U.S.C. 144 13

Rule 15cl-2 under the Securities Exchange Act of 1934, 17 CFR 240.15cl-2 18

In the Supreme Court of the United States

OCTOBER TERM, 1960

No. 854

LOS ANGELES TRUST DEED & MORTGAGE EXCHANGE, ET AL., *Petitioners*

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 54-94) is reported at 285 F. 2d 162. The Findings of Fact and Conclusions of Law of the district court are reported at 186 F. Supp. 830.

JURISDICTION

The judgment of the court of appeals was entered on November 23, 1960. A timely petition for rehearing was denied on January 10, 1961 (Pet. App. 95-98). The petition for a writ of certiorari was filed on March 28,

1961. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the nationwide sale of notes secured by second trust deeds on land located in California, where the seller promised to collect and remit or reinvest the proceeds and otherwise to service the trust deed notes, constituted the sale of "investment contracts," and hence "securities," under the Securities Act and the Securities Exchange Act.

2. Whether, in an action brought by the Securities and Exchange Commission to enjoin violations of federal securities laws (including the fraudulent misuse of investors' funds), the court, upon finding that such violations had occurred and that the issuing corporation was insolvent, may appoint a receiver to conserve its assets and maintain the *status quo* pending compliance with the federal securities law or the institution of bankruptcy proceedings.

3. Whether alleged procedural errors at the trial (the shortening of the usual notice period for motions with respect to depositions, refusal to permit examination of Commission officials, and admission of certain evidence) denied petitioners a fair trial.

4. Whether the court below correctly held that charges of bias against the district judge were unsubstantiated.

STATUTES AND RULES INVOLVED

Section 20(b) and Section 22(a) of the Securities Act of 1933 are set forth at pages 99 and 100 of the appendix to the petition. Other pertinent sections

of the securities Act of 1933, 48 Stat. 74, as amended, 15 U.S.C. 77a, *et seq.*, and the Securities Exchange Act of 1934, 48 Stat. 881, as amended, 15 U.S.C. 78a, *et seq.*, are set forth in the Appendix hereto, *infra*, pages 15 to 19.

STATEMENT

Petitioners were found to have engaged in the sale of unregistered securities in violation of the registration and anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. The illegal sales were made in connection with an investment plan called the "Secured 10% Earnings Program." The facts are set forth in the lengthy and detailed findings and conclusions of the district court, entered after a 37-day trial. (186 F. Supp. 830, 839-890).

While the plan varied in minor detail from time to time, its essential character remained unchanged. Petitioners promised investors depositing moneys under their program 10% earnings from the purchase of discounted notes secured by second trust deeds on California real estate. Petitioners undertook to "service" the trust deed notes for the investors. Such services included, *inter alia*, making monthly, quarterly or other periodic collections from trustors, remitting or reinvesting earnings, sending out delinquency notices and, where necessary, carrying out foreclosure procedures (186 F. Supp. at 846). Petitioners' profit was to be derived from the difference between the price they paid for the trust deed notes and the price at which they were sold to investors—both prices being below the face amount of the notes (186 F. Supp. at 843-848).

Investors in the program were given a portfolio containing copies of a note, a trust deed and assignment thereof, a policy of title insurance and an engraved Certificate of Registration and Ownership which was designed to resemble an engraved share of stock or a bond (186 F. Supp. at 848-849).

Although petitioners represented in their sales literature that the trust deeds were "seasoned," "prime," and "trouble-free" and had been carefully screened and appraised (186 F. Supp. at 850), they placed in investors' accounts with petitioner Los Angeles Trust Deed & Mortgage Exchange ("LATD") highly speculative trust deeds, created for the most part against units of unimproved, vacant land (186 F. Supp. at 849-852). In addition, by holding title as trustee to "service" many of the trust deeds (186 F. Supp. at 849) and by other devices, petitioners completely controlled these trust deeds and used this controlling position to petitioners' advantage and to the detriment of investors. Thus, in certain cases where the makers of the notes liquidated them in advance of the maturity date, petitioners appropriated the resulting "windfall" profits properly belonging to the investors (186 F. Supp. at 876-879).

To induce investment in the enterprise, petitioners promised investors a 10% return even before their funds would be invested in trust deeds. They represented that money deposited by the twentieth of the month would "earn" a 10% return from the first of the month. If, before a trust deed was assigned to an investor, he elected to receive his "earnings" monthly, petitioners would reduce the investor's ledger account on the books of petitioner LATD by an amount equal

to the "earnings" payment (186 F. Supp. at 878-879).

Further to assure the continued influx of investors' funds necessary to sustain the enterprise, petitioners formulated a policy of taking back defaulted trust deeds, so that they could claim that no investor had ever suffered a loss. This policy resulted in a continuous increase in inventory of a large quantity of unsaleable trust deeds (186 F. Supp. at 860). These defaulted trust deeds taken back from investors were carried on petitioners' books not at their cost but at the inflated prices at which they had been repurchased from the dissatisfied investors (186 F. Supp. at 862). Thus, as of March 31, 1959, after necessary accounting adjustments in the balance sheet of petitioner LATD, including an adjustment to reduce inventory of trust deeds from the inflated value at which they were carried, that petitioner was insolvent in the bankruptcy sense (186 F. Supp. at 861-865).

Petitioners sent out elaborate brochures through the mails to tens of thousands of investors from whom essential facts were withheld (186 F. Supp. at 872). In addition, investors were sent monthly statements of their accounts, which were designed to mislead them into believing that their accounts were growing in value, when, in fact, the amounts shown on the monthly statements were merely "projected" earnings representing no realizable value (186 F. Supp. at 878-879). Petitioners concealed their fraud and the precarious financial condition of their enterprise through the issuance of misleading financial statements (186 F. Supp. at 868).

Based on the foregoing findings, the district court entered a decree enjoining the petitioners from violat-

ing the registration and fraud provisions of the Securities Act and the Securities Exchange Act.[1] The court also appointed a receiver to liquidate the assets of LATD and of Trust Deed & Mortgage Markets (a separate corporation operated as a department of LATD), so that investors' funds would be adequately protected and the rights of investors equitably determined (186 F. Supp. at 890).

The court of appeals upheld the injunction, but modified the scope of the receivership. The court held that, under the tests formulated by this Court in *Securities and Exchange Commission* v. *Joiner Corporation*, 320 U.S. 344, and *Securities and Exchange Commission* v. *W. J. Howey Company*, 328 U.S. 293, petitioners were not merely engaged in the sale of real estate trust deeds, but were in fact offering and selling investment contracts within the meaning of Section 2(1) of the Securities Act and Section 3(a)(10) of the Securities Exchange Act (Pet. App. 57-71). It further ruled that the petitioners had violated the anti-fraud provisions of those Acts (Pet. App. 71). Although the court upheld the appointment of a receiver as necessary for the protection of investors, it eliminated the direction that the receiver should liquidate the enterprise (Pet. App. 87-94). It stated (Pet. App. 93) that "[t]he trustee in bankruptcy is the person to liquidate, if that be necessary, under the usual and ordinary supervision of a Referee in Bankruptcy":

---

[1] Previously, the district court had entered a preliminary injunction enjoining petitioners from violating these same sections and had appointed a receiver. The court of appeals had set aside those orders of the district court and remanded the matter for trial. Pet. App. 1-28; 264 F. 2d 199.

and that "the receiver here should be regarded as one pendente lite."

Following the entry of the judgment of the court of appeals and prior to the filing of the petition for a writ of certiorari, petitioners LATD and Trust Deed & Mortgage Markets were adjudicated bankrupts on December 19, 1960. The adjudication was made with their consent, on a petition filed by certain of their creditors. These two petitioners, therefore are now under the jurisdiction of the bankruptcy court, and are in process of liquidation. See *In re Los Angeles Trust Deed and Mortgage Exchange* (S.D. Calif., Cen. Div., Bankruptcy No. 118, 178-MC). The bankruptcy court has not authorized the filing of the petition for a writ of certiorari by these petitioners and the petition is not filed on behalf of the trustee in bankruptcy.

ARGUMENT

1. In holding that petitioners were selling investment contracts, the courts below correctly applied to the facts of this case the definitions of an investment contract formulated by this Court in *Securities and Exchange Commission* v. *Joiner*, 320 U.S. 344 and *Securities and Exchange Commission* v. *W. J. Howey Company*, 328 U.S. 293. In *Joiner*, the Court held that sales of leaseholds in specific portions of a tract of potential oil and gas land to widely scattered purchasers, coupled with the promoter's representation that it would drill an exploratory well to prove the potentiality of the tract, constituted sales of investment contracts within the purview of the Securities Act. The Court said (320 U.S. at 352-353):

> The test [in determining whether a security is involved] * * * is what character the instrument is

> given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect. *In the enforcement of an act such as this it is not inappropriate that promoters' offerings be judged as being what they were represented to be.* [Emphasis added.]

The principle inherent in *Joiner*, that an investment contract may be created without the investors sharing collectively or *pro rata* in the profits to be derived from an enterprise, was reaffirmed in *Howey*. There, individual orange tree groves were offered, together with contracts for their cultivation and harvests and sale of the produce. As noted by the Court of Appeals in that case, each purchaser looked to the "fruitage of his own grove and not to the fruitage of the groves as a whole."[2] As in *Joiner*, this Court, after examining the circumstances surrounding the sale of the groves, concluded that what was being sold was something more than fee simple interests in land, namely, an investment opportunity for profit to persons residing in distant localities. It said (328 U.S. at 300):

> Thus all the elements of a profit-seeking business venture are present here. The investors provide the capital and share in the earnings and profits; the promoters manage, control and operate the enterprise. It follows that the arrangements whereby the investors' interests are made manifest involved investment contracts, regardless of the legal terminology in which such contracts are clothed.[3]

---

[2] *Securities and Exchange Commission* v. *Howey Company*, 151 F. 2d 714, 717 (C. A. 5), reversed, 328 U. S. 293.

[3] Both the *Howey* and *Joiner* cases make clear that the term "investment contract," which prior to the adoption of the Securities Act also had been included in the definition of security in many

Similarly in the present case it was found that petitioners offered and sold something more than an interest in a note secured by a second deed of trust on real estate. Petitioners promised and investors were led to expect continuous 10% earnings on their moneys because of (a) petitioners' ability to select, screen, appraise and acquire suitable trust deeds; (b) their servicing and collection of loans; (c) their handling of foreclosures, if necessary, or their repurchase or resale of notes of dissatisfied investors. In addition, petitioners impliedly guaranteed against loss of investment[4] (186 F. Supp. at 887). Many investors depositing funds with petitioners lived far from the lands which secured their investment and, therefore, could not themselves service their investment (*ibid.*). They were dependent upon the promoters to make the investment opportunity feasible and valuable. The court of appeals thus correctly held that petitioners and investors were engaged in a common enterprise, since the investors had an economic interest "inextricably woven with the ability of LATD to locate by the exercise of its independent judgment a sufficient number of discounted trust deeds, and the ability of LATD subse-

---

state blue sky laws, has continuously been utilized to cover transactions in which the investor looks to the efforts of the managers of the enterprise for success of his investment. See cases discussed in *Securities and Exchange Commission* v. *Joiner*, 320 U.S. at 352, note 10, and *Securities and Exchange Commission* v. *W. J. Howey Company*, 328 U.S. at 298-299.

[4] Petitioners refer to and quote from (Pet. 20-22) Plaintiff's Exhibit 32, a sales brochure used by petitioners to induce investments. As petitioners point out, this particular brochure was used since February 1959. But petitioners fail to note that it is a brochure that was revised to meet certain of the charges arising from this suit, which was instituted early in February of 1958. Earlier brochures did not contain the quoted language.

quently to meet its commitments, to check, evaluate, supervise, and supersede" (Pet. App. 70).

The judgment below may, in large part also be sustained on the alternative ground that, whether or not petitioners were selling "investment contracts," the notes they were selling were themselves "securities." Section 2(1) of the Securities Act defines the term "security" to include "any note" and "any evidence of indebtedness," and Section 3(a) (10) of the Securities Exchange Act defines "security" to include "any note." The district court's findings of violations were based not only upon sales of investment contracts, but also upon the sales of the underlying trust deed notes. 186 F. Supp. at 886-887. Since the violations found with respect to the notes involved only the anti-fraud, and not the registration, provisions of the Acts, those violations might not support paragraph I of the injunction, prohibiting the sale of unregistered securities; nor would they support paragraph V prohibiting the corporate petitioners from acting as brokers or dealers without registration. (186 F. Supp. at 834, 837-838). They do, however, clearly support all the other provisions of the judgment (directed against petitioners' fraudulent activities), including the receivership.

2. The court of appeals eliminated the direction in the order of the district court that the receiver was to liquidate the two corporate petitioners, on the ground that "[t]he trustee in bankruptcy is the person to liquidate, if that be necessary," and that the receiver was to be "one pendente lite" (Pet. App. 93). Since these petitioners have now been adjudicated bankrupts, however, and a trustee in bankruptcy has been appointed to liquidate them, the receivership pendente

lite has been superseded. Accordingly any issue as to whether the courts below properly placed them in receivership is moot. Moreover, there is a serious question whether these petitioners may now seek review, since the bankruptcy court has not authorized such action and the petition in their behalf is not filed for the trustee. Section 11(*c*) of the Bankruptcy Act, 11 U.S.C. 29(c).

In any event, the court below correctly sustained the appointment of the receiver. The Commission's suit invoked the equitable powers of the district court pursuant to Section 22(a) of the Securities Act[5] and Section 27 of the Securities Exchange Act. The receivership, as modified by the court of appeals, was ancillary to the injunction and appropriate to effectuate the purpose of those Acts of affording full protection to investors. Cf. *Mitchell* v. *DeMario Jewelry*, 361 U.S. 288, 291; *Porter* v. *Warner Holding Company*, 328 U.S. 395, 398; *Aldred Investment Trust* v. *Securities and Exchange Commission*, 151 F. 2d 254, 260-261 (C.A. 1). It was justified by (1) the flagrant nature of the fraud found, including the misuse of investors' funds deposited with petitioners, and (2) the finding that, as of March 31, 1959, petitioner LATD was insolvent in the bankruptcy sense. In these circum-

[5] Petitioners' discussion of Section 20(b) of the Securities Act (Pet. 4, 9, 25-28) confuses the authorization in that section, empowering the Commission to institute injunctive actions, with the provisions of Section 22(a), granting jurisdiction in the district courts to adjudicate *all suits* "in equity and actions at law brought to enforce any liability or duty created" under the Act. *Deckert* v. *Independent Shares Corporation*, 311 U. S. 282, relied upon by petitioners on this point, held, as petitioners state, that Section 22(a) of the Securities Act governs private actions under the Act. But that determination does not mean that injunctive suits brought by the Commission are not also governed by Section 22(a).

stances, it was proper to remove the investors' funds from petitioners' control, and thus prevent further abuse.

Contrary to petitioners' contention (Pet. 23-25), the decision below is not in conflict with *Gordon* v. *Washington*, 295 U.S. 30, and *Kelleam* v. *Maryland Casualty Co.*, 312 U.S. 377. Those cases hold that a federal court should not appoint a receiver unless it is ancillary to some other relief. Here, as we have shown, the appointment was ancillary to the injunction.

3. Petitioners' claims of procedural errors which allegedly denied them a fair trial (Pet. 11-17) are essentially (a) that the trial court should not have shortened the usual notice period for motions with respect to depositions, (b) that it should have permitted petitioners to examine officials of the Securities and Exchange Commission to prove such matters as that "never in the history of the SEC had it ever accepted for registration, or considered available for registration, single trust deeds or mortgages, such as petitioners were dealing in" (Pet. 15) and (c) that certain exhibits offered in evidence by the Commission should have been excluded, specifically a schedule prepared by Commission investigators based upon petitioners' records. But these were matters primarily within the discretion of the trial judge, and there is no showing that the latter's rulings were erroneous. Moreover, such minor alleged errors during a 37-day trial obviously did not deny petitioners a fair trial.[6]

---

[6] For a discussion of the petitioners' contumacy in opposing pretrial discovery, see *Securities and Exchange Commission* v. *Los Angeles Trust Deed & Mortgage Exchange*, 24 F.R.D. 460 (S.D. Calif.).

4. The court of appeals carefully considered all of petitioners' charges of bias on the part of the district judge and determined that they were without substance. Petitioners' Question 6 (Pet. 5, 10-11) and the discussion thereof (Pet. 29-33) misconstrue the decision of the Court of Appeals. Contrary to the petitioners' assumption that that court "tacitly" conceded "evidence of bias and prejudice" on the part of the trial judge (Pet. 29), the court stated only that certain remarks charged to have been made informally in chambers by the trial judge "would have been better left unsaid." It held, however, that the alleged statements did not prevent a "fair trial," and that petitioners' affidavits provided "no evidence of bias in the personal sense contemplated and required by the statute" (Pet. App. 74).

Petitioners' Question 5 (Pet. 4-5, 10) and the discussion thereof (Pet. 28) are irrelevant since petitioners discuss a procedure that was not followed below, *i.e.*, the filing of a counter-affidavit by a district judge to an affidavit of bias and prejudice under 28 U.S.C. 144. The opinion of the court of appeals makes clear that it gave careful consideration on appeal to the validity of the petitioners' affidavits—the very procedure which the cases cited by petitioner suggest should be followed.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

ARCHIBALD COX,
Solicitor General.

WALTER P. NORTH,
General Counsel,

DAVID FERBER,
Assitant General Counsel,

F. E. KENNAMER, JR.,
JOHN A. DUDLEY,
Attorneys,
Securities and Exchange Commission.

APRIL, 1961.

APPENDIX

Securities Act of 1933

(48 Stat. 74, as Amended, 15 U.S.C. 77a, et seq.)

SEC. 2. When used in this title, unless the context otherwise requires—

(1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt, for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

* * *

SEC. 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

* * *

(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate com-

merce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 8.

SEC. 17. (a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Securities Exchange Act of 1934

(48 Stat. 881, as Amended; 15 U.S.C. 78a, et seq.)

SECTION 3. (a) When used in this title, unless the context otherwise requires—

* * *

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment con-

tract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

SECTION 15. (a) No broker or dealer (other than one whose business is exclusively intrastate) shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, unless such broker or dealer is registered in accordance with subsection (b) of this section.

* * *

(c) (1) No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, by means of any manipulative, deceptive, or other fraudulent device or contrivance. The Commission shall, for the purposes of this subsection, by rules and regulations define such devices or contrivances as are manipulative, deceptive, or otherwise fraudulent.

* * *

SECTION 27. The district courts of the United States, and the United States courts of any Territory or other

place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duly created by this title or rules and regulations thereunder, or enjoin any violation of such title or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 225 and 347). No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts.

Rule Under the Securities Exchange Act of 1934

(17 CFR 240.15cl-2)

Rule 15cl-2. Fraud and misrepresentation.

(*a*) The term "manipulative, deceptive, or other fraudulent device or contrivance," as used in section 15 (*c*) (1) of the act, is hereby defined to include any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

(*b*) The term "manipulative, deceptive, or other fraudulent device or contrivance," as used in section 15 (*c*) (1) of the act, is hereby defined to include any untrue statement of a material fact and any omission

to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, which statement or omission is made with knowledge or reasonable grounds to believe that it is untrue or misleading.

(c) The scope of this section shall not be limited by any specific definitions of the term "manipulative, deceptive, or other fraudulent device or contrivance" contained in other rules adopted pursuant to section 15(c) (1) of the act.

☆ U. S. GOVERNMENT PRINTING OFFICE 1961—892197/P. C. 1238